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The Fiscal Consequences of Peace

Taxation and veto power in post-conflict countries

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Abstract

Effective and fair taxation is imperative for development and thus sustainable peace in post-conflict countries; yet there is a glaring paucity of generalizable research on the subject. Drawing on theories from Political Economy and Comparative Politics this thesis investigates how political veto powers affect these states' ability to mobilize domestic resources. An integrated model of delayed policy adjustment is presented and applied to the economic structure and political institutions of post-conflict countries. It is predicted that the number of veto players and the existence of power-sharing agreements inhibits fiscal policy reform resulting in forgone tax revenues. Utilizing a mixed-methods research design, a statistical analysis is conducted using data from 34 post-conflict recovery periods. These results in turn guide the selection of two cases (Uganda and Lebanon) for in-depth investigation, geared towards evaluating the proposed causal process.

The combined results show that veto power does matter for post-conflict revenue mobilisation, in so being that power-sharing agreements inhibits swift and comprehensive fiscal reform, resulting in lower levels of tax revenue. While the results for veto players were less conclusive, the case study analysis confirmed the existence of serious validity problems, indicating the need for better data on political institutions in developing countries.

Key words: post-conflict recovery, veto players, power-sharing, fiscal policy, tax revenue

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Table of contents

1 Introduction 1

2 Previous Research 3

2.1 Liberal Peacebuilding 3

2.2 Political Economy of Peacebuilding 3

3 Theory: Comparative Political Economy 6

3.1 Theoretical point of departure 6

3.2 Alternative Models 7

3.3 War of Attrition – adjusting too late 7

3.4 Veto Players 9

3.4.1 Integrating Veto Players into the WoA model 10

3.4.2 Application to taxation in post-conflict countries 11

3.5 Power-Sharing 12

4 Research design and methodology 15

4.1 Mixed-methods design: Nested Analysis 15

4.2 Defining post-conflict recovery 16

4.3 Large-N methodology 16

4.4 Variable operationalization 17

4.5 Case selection strategy 20

4.6 Small-n methodology 21

4.7 Case study structure and qualitative indicators 22

5 Statistical analysis 25

5.1 Results of the regression models 25

5.2 Interpretation of the statistical results 29

6 Case study section 30

6.1 Case selection 30

6.2 Uganda 1992-2006 31

6.2.1 Background 31

6.2.2 Political structure 32

6.2.3 Fiscal reform 33

6.2.4 Tax structure 35

6.3 Lebanon 1990-2004 38

6.3.1 Background 38
6.3.2 Political structure 39
6.3.3 Fiscal reform 40
6.3.4 Tax structure 44
6.4 Analysis of case study results 46

7 Concluding discussion 49

8 References 51

9 Appendix I. Sample delineation 63

10 Appendix II. Data description 66

1 Introduction

> *"... and they settled it as a problem of theology, of politics, of electoral chicane, from every point of view except that of the economic future of the states whose destiny they were handling."*
>
> –John Maynard Keynes

Shortly after resigning from his position as a delegate for the British Treasury at the Versailles conference, John Maynard Keynes published "The Economic Consequences of the Peace" (1920 p.2), in which he vehemently criticizes the draconian provisions of the Versailles Treaty, dramatically emphasizing that these were matters "of life and death, of starvation and existence, and of the fearful convulsions of a dying civilization." In short, not only were the economic aspects of the peace strikingly absent from the treaty, but the few provisions that did exist were motivated by vengeful moral reasoning rather than a quest for peace and prosperity.

Whether or not the character of the Versailles Treaty should be considered an indirect cause of the Second World War that broke out two decades later is an open question, but history did sadly prove Keynes right in terms of the abysmal economic performance of Europe in the interwar period.

This tough lesson led to a distinctly different – if not to say contrary – approach among the Allied forces the second time around. In the early 1940's, with the war still raging across the world, Keynes and his American counterpart Harry Dexter White started negotiations on the postwar economic system (Ikenberry 1992). This time around, the aim was to reap the benefits of international trade while achieving stability and welfare for all citizens; the means to which were cooperation rather than repressive competition. Accordingly, the ensuing Bretton Woods Agreement established a system which was described by Ruggie (1982) as *embedded liberalism*. In vivid contrast to the interwar period, this regime fostered remarkable stability in Europe, in economic as well as political terms.

Still liberal, but hardly "embedded", the dominant post-Cold War paradigm in post-conflict situations is that of *liberal peacebuilding*. It assumes that liberal representative democracy and a free market economy go hand in hand, and together promotes peace and stability. But, as emphasized by many scholars, what may be true in general might not hold for deeply divided societies emerging from conflict, where elections and economic liberalization risks causing instability rather than peace (Paris 2004). Mostly, however, this has been framed as a question of timing and degrees of liberalism.

Leftwich (2005) raises a far more troubling question: are representative democratic institutions compatible with development-promoting policy? He

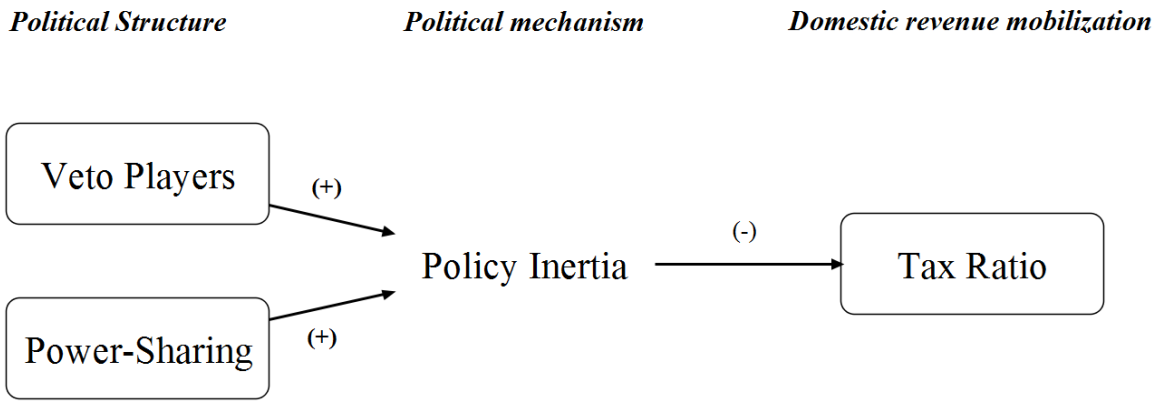
claims that in so far as development entails some sort of transformation of the economic structure of society – distribution as opposed to mere growth – political institutions designed to protect the interests of *all* societal groups stand in tension with it. While having a far more modest scope than the above question implies, this study draws on the same basic notion: i.e., that there may be a trade-off between representativeness on the one hand, and capacity for resolute structural change on the other.

The most fundamental and potentially the most influential of such interventions in the economic structure of society is the collection of revenues by the state and the subsequent allocation of resources and public goods. At the same time, the question of political inclusion and representation is of paramount importance in countries emerging from war.

This study will therefore seek to answer the following question: *How does the political structure affect the state's ability to mobilize domestic revenue during post-conflict recovery?*

To answer this question, the present study will establish a theoretical framework based on a political economy model of *delayed adjustment*. It will be argued that the political structure – denoting the distribution and prevalence of *veto powers* – has a decisive impact on the government's ability to implement reforms. Specifically, a larger number of *veto players* and the existence of *power-sharing agreements* are predicted to cause policy inertia during post-conflict recovery. This in turn has negative consequences for the mobilization of domestic revenue, as indicated by low tax revenues. The argument, illustrated in Figure 1, produces two hypotheses which will be evaluated using a mixed-methods research design. First, a statistical analysis will be conducted using a sample of 34 post-conflict countries experiencing recovery periods between 1990 and 2015, in order to test the hypothesized *causal effects*. On the basis of these results, two cases will be selected for qualitative in-depth study, the main purpose of which is to investigate the validity of the proposed *causal mechanism*.

Figure 1. Hypothesized causal chain



2 Previous Research

2.1 Liberal Peacebuilding

While just as important as in the aftermath of WWII, the economic aspects of post-war recovery nonetheless receive remarkably less scholarly attention than do purely political or security-related questions in modern post-conflict situations (Pugh *et al.* 2011 p.2). This is not to say that economic aspects are completely ignored – indeed, as it is recognized as a major component of modern peacebuilding operations (Paris 2004 p.19), policies such as privatizations and the liberalization of trade and capital movements have been scrutinized by scholars studying liberal peacebuilding. In this – often highly critical – strand of research, liberal peacebuilding is viewed as a fairly coherent paradigm premised on the idea that liberal societies, characterized by a free market economy, representative democracy and the rule of law, will ultimately be more peaceful (Newman *et al.* 2009 p.11).

While this literature has highlighted the problems of economic liberalization in war-torn societies, it has been less interested in investigating the causes behind various policies; most often, the *a priori* assumption is that policies are exogenously derived from international actors, be they International Financial Institutions (IFI) or powerful states. As several studies have shown, however, neither the proscription of policies by IFI's nor its actual implementation is uniform across societies, but is crucially contingent on domestic factors (Dollar & Svensson 2000; Nooruddin & Simmons 2006).

2.2 Political Economy of Peacebuilding

There is a small strand of research focusing on what may be termed the Political Economy of peacebuilding. On a very general note, this research is interested in the relationship between state, society and markets, and the tension between on the one hand the continuance of war-time relations and on the other the efforts, by internal and external actors, to transform them in the post-conflict phase (Berdal & Zaum 2013 p.4f.). Importantly, this entails looking at both formal institutions

(constitutions, specific policies) and informal ones (networks of trust, illicit economies); and analyzing the domestic as well as the international level.

One important strand of research in this field is focused on the effects of natural resource rents on political stability and post-conflict development, and how to design proper political institutions to mitigate their potentially adverse effects (e.g. Benner *et al.* 2013; Le Billon 2012; Lujala *et al.* 2010; Wennmann 2011).

An overlapping subject of inquiry is that of illicit or "shadow" economies – established during the war and a challenge to get rid of in its aftermath. While the engagement in non-formal economic activity can be regarded as a necessary survival strategy of the poor (e.g. Nordstrom 2004; Raven-Roberts 2013), it can also form the economic basis for rebel groups (Shaw & Mangan 2014, on Libya), fuel corruption (Pugh 2013), as well as being an obstacle for state revenue collection (Newman & Keller 2007; Wennmann 2004; Willett 2011 p.79).

Hence, both of the above phenomena have an impact on the ability of the state to collect revenue, and consequently to supply public goods for the promotion of security and development.

Other studies have focused on the impact of *international actors* on the public finances (e.g., Le Billon 2008, on corruption). As opposed to the abovementioned liberal peacebuilding literature, which generally deals with the consequences of neo-liberal economic policies, taking the influence of IFI's as a given, a political economy approach typically studies the interaction between IFI's and domestic actors and structures. This is certainly an important contribution. But as Susan Woodward (2013 p.141) points out, this research is almost completely conducted using single case studies, which although capable of providing in-depth understanding of complex interaction, fails to capture more generalizable patterns of variation.

There is now a consensus among major peacebuilding actors and donors regarding the centrality of strengthening domestic fiscal capacity in post-conflict states (Boyce & Forman 2010 p.1). In spite of the normative commitment, however, there is a glaring paucity of scientific studies on the issue. Descriptively, we know that post-conflict countries typically have low revenue levels and high deficits (Hoeffler 2012 p.14), but assessments are often based on small samples with non-systematic selection (see Gupta *et al.* 2004; UNDP 2008, for the best exceptions). Most research have instead focused on the practical issues of rebuilding fiscal institutions, using either single (see contributions in Boyce & O'donnell 2007) or multiple case studies (e.g Addison & Murshed 2001; Gupta *et al.* 2007).

Yet again, however, the lack of systematic cross-country comparisons results more in policy recommendation than causal explanations. We therefore know very little about how political institutions in post-conflict countries may affect the state's public finances.

Hence, while not refuting the importance of the broadly liberal influence of international actors, the ambition of this study is to open up the "black box" of how *domestic political structures* affect crucial aspects of post-conflict economic policy. The decision to focus on the distribution of veto powers in the political

system is motivated by it being one of the most salient political issues in peacebuilding. Indeed, in post-conflict contexts, rather than being a supposedly unintentional consequence of the constitutional design, the rule by large coalitions or other *power-sharing* configurations is often the intent of the actors in charge, explicitly designed to preserve the peace (Jarstad 2008 p.106; Lijphart 2004). However, in order to find systematic patterns and draw causal inferences about the effects of the domestic political structure on the state's ability to mobilize revenues during post-conflict recovery, we first need to gain some theoretical insights from the general literature of comparative political economy.

3 Theory: Comparative Political Economy

It should be stated at the outset that the political economy models presented below adheres, more or less strictly, to rational choice assumptions. While this makes it possible to construct complex and formally valid models, it arguably also makes them less easily applicable to actually existing political situations.

In order to validly test the propositions derived from the theory, it is therefore helpful to incorporate concepts from comparative politics – concepts that have the great benefit of being developed with actual political institutions as their point of departure. Therefore, the concept of *veto players* will be introduced and integrated into the causal model. The model will then be applied to tax revenue in the specific context of post-conflict recovery.

Finally, recognizing the political specificities of post-conflict countries, the concept of *power-sharing* will introduced as second, alternative source of veto power.

3.1 Theoretical point of departure

A common theoretical starting point for research on the effect of political institutions on economic policy and outcomes is Barro's (1979) theory of "'optimal' public finance", by which a "benevolent social planner" is assumed to make fully rational choices to maximize the utility for the population. Simply put, in order to keep the tax rates as constant as possible over time, the government will resort to issuing bonds to finance the deficit when faced with temporary economic hardship. While obviously being a normative model, Barro (1979) claimed that this "tax-smoothening model" had descriptive validity as well.

As Alesina & Perotti (1995a) points out in their survey of the research field, it has become increasingly obvious that this kind of model fails to explain both the large and long-term changes in global debt ratios, and especially the significant cross-country variations that are empirically evident. Hence, most research since then implicitly seeks the answer to why government policy differs from this "optimal" model.

3.2 Alternative Models

There is a multitude of theoretical models, with varying empirical evidence, explaining the influence of political factors on public finance. Roubini & Sachs (1989) conducted an early study in which they showed that "weak" governments accrue larger deficits. While presenting several plausible explanations (*ibid.* p.924f.), they could not empirically discriminate between them. Since then, formal models explaining variation in public finances has proliferated (see Alesina & Perotti 1995a; Eslava 2011). While some emphasize tax-payer's (mis)calculations, electoral rules (Persson & Tabellini 2000; 2003, for an overview), or the dynamics of government change (de Haan & Sturm 1994; Roubini 1991), what is relevant for this thesis is the effect of the *political structure*.

One of the more prominent of these is the *common-pool model*, which links the government structure to the level of government spending rather than tax revenue or deficits *per se*. Here, excessive spending is assumed to arise due to the discrepancy between the number of people bearing the cost of spending (through taxation or debt) and those who benefit from it; while costs are spread more or less across all groups, the benefits can be directed to one specific constituency (von Hagen 2008 p.465). Put differently, each group internalizes all the benefits but only a fraction of the costs of spending increases – with the fraction being inversely proportional to the number of represented groups (Perotti & Kontopoulos 2002 p.195). The larger the number of distinct constituencies that are represented in the government, therefore, the stronger the tendency to spend above an assumed optimal level (see Velasco 2000 for a formal model). Indeed, there is quite strong empirical evidence indicating that the common-pool problem contributes to a negative budget balance, at least in developed countries on which most studies have focused (e.g. de Haan *et al.* 1999; Volkerink & de Haan 2001; Perotti & Kontopoulos 2002; Ricciuti 2004; Wehner 2010). Importantly, however, since most studies only measures the budget balance rather than revenue changes, it is difficult to empirically discriminate between the common-pool model and the War of Attrition model, presented below.

3.3 War of Attrition – adjusting too late

In the War of Attrition model, as first proposed by Alesina & Drazen (1991), the inefficiencies are not a result of parties with conflicting interests agreeing on a sub-optimal policy; but rather that they *fail to agree* on a new fiscal policy when faced with an exogenous shock. The sup-optimal outcome is thus the result of a *failure to adjust revenue levels to new economic conditions*.

The focus on the War of Attrition-model is motivated by two separate conditions present in the population of interest. First, post-conflict countries typically experience dramatic economic changes to which the government fiscal policy has to be adjusted. Second, modern post-conflict countries are typically highly polarized. Even if the polarization is not primarily along a fiscal policy dimension, conflicts regarding other policy areas are likely to spill over and affect the incentives for compromises regarding the government budget. It is consequently highly likely that the mechanisms proposed by the model are operational in the periods under study.

Like the common-pool model, it assumes that parties in government represent groups with differing economic interests, but in contrast assumes that the costs of revenue collection will *not* be distributed equally among them. Hence, for a given adjustment policy there will always be winners and losers.

Therefore, even when the government is forced to resort to costly debt financing (or simply printing money as in Alesina & Drazen 1991 p.1174), given that the parties have sufficiently different economic interests, they will engage in a "war of attrition" rather than immediately adopting a second-best adjustment policy. The rationale behind this is that both parties hope that the cost of preserving *status quo* (shared by both parties, whether framed in economic or political terms) for the opposing party will eventually exceed its perceived cost for conceding to the non-preferred policy (Alesina & Perotti 1995a p.17). The effect of this mechanism is therefore dependent on the polarization between parties (raising the cost of losing), and on the number of parties with veto powers. A strongly polarized political environment with a large number of veto wielding parties, will therefore result in delayed adjustment to exogenous shocks and therefore larger deficits.

It is important to keep in mind that unlike the common-pool mechanism, the War of Attrition mechanism is "dynamic", i.e. is assumed to be operational under the specific circumstances of economic shocks. This is in line with the early findings of Roubini & Sachs (1989 p.923) who noted that the effect of a weak government on deficits was much more pronounced during adverse economic circumstances. Likewise taking into account difficult economic conditions, Franzese (2002 p.156) finds stronger evidence for the War of Attrition model than any other competing model.

Moreover, two separate studies investigating American states' government deficits *during recession* confirms that the existence of strong veto powers increases deficits. Focusing on the ability of different branches of government to veto budgets, Alt & Lowry (1994), finds that divided governments on average fail to adjust their revenues to economic changes, leading to larger deficits during downturns. Directly measuring the *time* until adjustment rather than the deficit level, Poterba (1994) shows that divided governments – where different parties control the executive and legislative branch – reacts slower to unexpected economic shocks.

Utilizing a more fine-grained measurement of the fiscal accounts in a qualitative approach, Alesina & Perotti (1995b p.233) shows that coalition governments are almost always unsuccessful in stabilizing the budget within the

first couple of years. Instead directly measuring *fiscal policy change*, Hallerberg & Basinger (1998 p.347) echoes these finding.

From the above theoretical and empirical review of the War of Attrition-model, we can conclude that political systems characterized by many actors with veto powers will likely suffer from policy inertia, which in a context of economic shock has negative fiscal consequences. In the referred to literature however, the operationalizations often have dubious validity (Kontopoulos & Perotti 1999 p.83). In order to more stringently conceptualize – and thereby being able to validly operationalize – the salient political factors for the causal mechanism at hand, we now turn to Tsebelis' (2002) theory on *veto players*.

3.4 Veto Players

Tsebelis (2002 p.19) defines veto players as "individual or collective actors whose agreement is necessary for a change of the status quo". These, in turn, are generally constituted by two partly overlapping categories: (1) *institutional veto players* are those directly given by the constitution and (2) *partisan veto players* are those that arise due to the political game (Tsebelis 2002 p.79). Examples of the first include lower and upper chambers of parliament, the presidency and constitutional courts; the latter consists of parties that due to their position within these institutions have an effective veto. In addition, if actors external to the political system – such as the military, IFI's or strong labour unions – has the ability to veto policy changes, they can also be considered veto players (Tsebelis 2002 p.35f.). In any given situation all of these can be conceived of as *potential* veto players; whether or not they function as veto players is determined by the specific policy in question.

All veto players are assumed to have fixed preferences in any given policy issue. More importantly, they all have a point on a policy-scale beyond which they will veto any proposal. This can be described as a two-dimensional space – for simplicity in the shape of a circle – with the veto player's preference in the center and whose outer bound consists of its *indifference curve*, i.e, the limit beyond which all policy proposals are deemed unacceptable. If there is only a single veto player in the system (which has the agenda setting prerogative), it can propose any policy it prefers to the *status quo* and implement it. With an additional veto player, however, the new policy must be placed where the two players' area of acceptance overlap, for any change of the *status quo* to take place. With the addition of a third veto player, the overlap may shrink further or disappear altogether, because some or all of the previously possible policy alternative are unacceptable to the third veto player (Tsebelis 2002 p.24).

Note that in a one-dimensional policy issues (e.g. the rate of a specific tax), only the two extreme veto players (and their polarization) will affect the policy inertia (Tsebelis 2002 p.26f.). Most significant policies involve multiple

dimensions, however, making it highly unlikely that an additional veto player will not affect the possibility of implementing reforms.

Hence, in general, more veto players and larger distance between them in terms of acceptable policies, will result in a smaller set of acceptable policies different from the status quo; given enough veto players or preference polarization, no change from the status quo will be possible. Hence, veto players crucially determine the degree of *policy inertia*.

3.4.1 Integrating Veto Players into the WoA model

As Tsebelis (2002 p.189) notes, the above theory is congruent with Alesina & Drazen's (1991) War of Attrition model, in so being that the ability to implement substantial policy changes is a function of the number of actors with veto powers as well as their polarization. The one significant difference is that while the former is static the latter is dynamic.[1] Put differently, while Tsebelis model emphasizes the possibility and substantiveness of policy change at any given moment, Alesina & Drazen (1991) focus on the time it takes for a substantial change to take place.

This, however, is easily bridged. The essential factor included in Alesina & Drazen (1991 p.1174) is the secularly increasing costs – economic and political – of each actor to preserve the status quo and continue the political struggle. When for one of the parties, the costs of continuing the struggle exceed the costs of acceding to a non-preferential policy change, it will give up and accept the rival's policy.

However, we may just as well incorporate the rising costs of preserving the *status quo* into the preferences of the veto players. As time passes and costs rise, the *area of acceptable policies* for each veto player will increase, until they finally overlap, and they can reach a compromise that is *acceptable* to both parties and *preferable to the status quo*.[2] Figure 2 below provides a simple illustration of this integrated model, which forms the theoretical basis for the thesis. While initially there is no overlap of the three veto player's respective area of acceptable policy (full circles), as the costs of non-adjustment rise for each of them, this area expands (dashed circles) until they overlap (black area), and a new policy can be accepted.

We now have a theoretical model with internal validity (and indeed empirical support) able to describe how political structures affect a governments ability to adjust its policies in the face of rapidly changing economic circumstances. The crucial benefit of Tsebelis (2002) conceptualization of veto players is that it

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[1] Tsebelis (2002 p.34) does certainly discuss the "dynamic" process of *agenda setting*, but this is not relevant for our purposes.

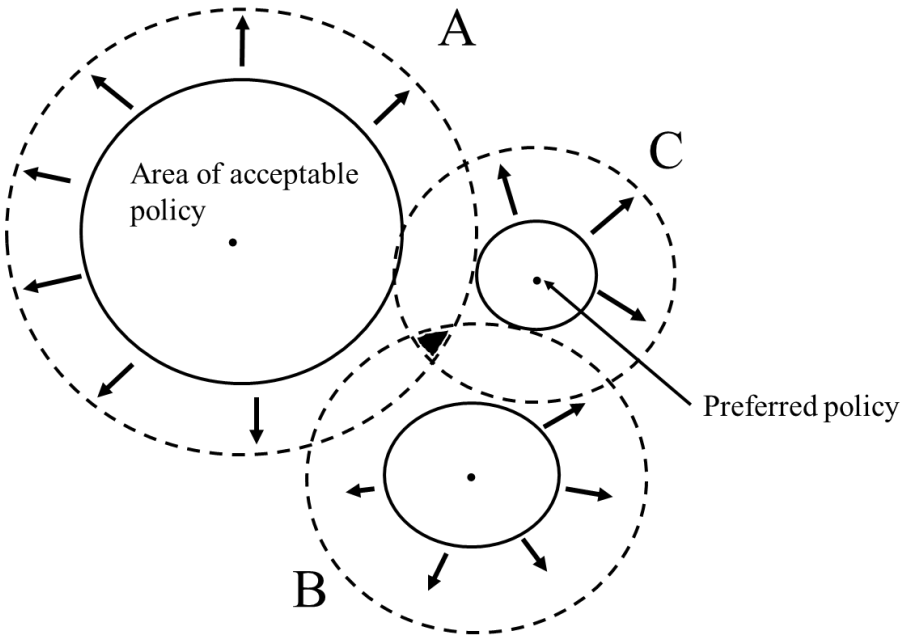
[2] Again, in Tsebelis' (2002) terminology, the eventual overlap of the *indifference curves* of the veto players will create a *winset of the status quo.*

validly captures the relevant political aspects of the War of Attrition model, while being concretely applicable to all existing political systems.

For example, the only theoretical difference between a democratic and an authoritarian system with respect to veto players is how they are *selected*. While this may imply a difference in political costs concerning non-adjustment (in democracies *some* veto players can be punished by the electorate), it does not necessarily imply differences in terms of veto players' preferences in relation to the status quo – or the electorate (see Tsebelis 2002 p.77).

The identity of veto players will certainly differ between systems: in parliamentary systems they consist mainly of government parties; in presidential systems the different branches of government are more important; federal systems in turn have distinct but highly varied forms of veto players. The important point is that a veto player thus conceptualized, should have the same effect regardless of the political system.

Figure 2. Integrated model of theoretical mechanism



3.4.2 Application to taxation in post-conflict countries

As already pointed out, post-conflict countries are typically characterized by a high degree of *polarization*. On the other hand, in contrast to stable industrialized countries (having ideologically distinct parties, opinion polls, etc.), this polarization is close to impossible to quantify. Consequently for the purpose of

this study, polarization will be treated as a constant.[3] Hence, proceeding to focus on the *number* of veto players, it is expected that a large number of veto players will result in high *policy inertia* in post-conflict countries. The second question is what this implies in terms of the ability to mobilize domestic revenue.

In the literature reviewed above, focusing on the budget balance a "negative economic shock" is often constructed as a simple recession whereby government revenues decline and slow adjustment therefore results in high budget deficits.

While post-conflict growth rates crucially hinge on the duration of the preceding war (Collier 1999 p. 176), these economies are typically characterized by rapid *growth* (Chen *et al.* 2008 p.72; Hoeffler *et al.* 2010 p.4). Spontaneously, this could lead us to expect that high policy stability would result in high revenues (and budget surpluses).

But whereas in well-functioning industrialized states it is mostly a question of time before GDP growth translates into increased government revenue, this is obviously not true for a country whose fiscal institutions are in ruins after a war. Typically, post-conflict governments inherit high budget deficits, and low levels of revenue from the conflict-period (Gupta *et al.* 2004 p.411; UNDP 2008 p.107f.). Therefore the flow of tax receipts will critically depend on the government's ability to rebuild effective fiscal institutions and implement new fiscal policies, regardless of the prevailing economic conditions. Policy inertia will therefore result in lower tax revenues.[4] The first hypothesis is therefore as follows:

> H1: *post-conflict counties with more veto players will mobilize lower levels of tax revenue during the recovery period.*

3.5 Power-Sharing

As emphasized above, the main benefit of the veto player concept is its ability to travel across widely different political institutions. On a purely theoretical level, not even the existence of stable political institutions is necessary; as noted, a veto player can be wholly informal, exercising its power from without the political system. In operational terms, however, the relative strength of institutions is a crucial factor. As Bräutigam (2008 p.11) notes regarding the fiscal structure of

[3] This decision probably has insignificant empirical implication: in one of the most ambitious studies on the WoA-model Franzese (2002 p.175) finds that while the number of veto players has a significant effect on budget deficits, their polarization does not.

[4] The application to post-conflict countries is certainly not novel to this study. Indeed Alezina & Drazen (1991) use the post-WWII experiences of different European countries to empirically illustrate their War of Attrition model.

developing states, it cannot be assumed that certain institutional configurations will have the exact same effect in developing as in developed countries.

This has also been empirically corroborated. For example, it has been shown that the effect of the number of spending ministers in cabinet on deficits is markedly weaker outside of the OECD (Woo 2003 p.399). With similar results, Elgie & McMenamin (2008 p.264) presents evidence to the fact that the common-pool problem may hinge on the level of political institutionalization.

Naturally, in post-conflict countries, the surviving formal political institutions may accord very little real power to actors working within them. Likewise, newly established political institutions might provide scarce information about the real distribution of political power.

Hence, while the conceptualization of veto players may still be valid in its most abstract terms – i.e., any actor which has the power to veto a decision – it is possible that in a post-conflict context, they do not arise either through the constitution nor through the party system. Instead it is likely that much of the veto-power of actors is determined by their relative power at the end of the conflict, or more precisely the political arrangement agreed upon as part of a peace agreement (or lack thereof). These provisions may be essential for the establishment of effective political veto powers in the countries at hand; after all, by their very nature peace agreements cannot be violated without risking the resumption of armed conflict.

After the end of the Cold War it has become increasingly common to establish power-sharing agreements as an essential part of the post-conflict settlement (Hartzell & Hoddie 2015 p.41). Though the precise meaning of power-sharing is a matter of debate, it is conceptually rooted in what Lijphart (1969 p.216) termed *consociational democracy*, meaning "government by elite cartel designed to turn a democracy with a fragmented political culture into a stable democracy." More precisely, it implies the representation of all "significant communal groups in political decision making" (Lijphart 2004 p.97). It often also entails some form of group autonomy and guaranteed proportional representation of groups in e.g., the legislative chamber or within the public administration (*ibid.*). While some scholars emphasize the *ethnic* dimension of *consociationalism* (e.g., Horowitz 2014), this is not a necessary criterion for power-sharing.

Furthermore, in the context of conflict settlements, the concept is often even wider and may also be less than fully inclusionary. More reflecting the distribution of power than the theoretical ideal, they often exclude important groups, while privileging extreme ones or those in possession of the means of violence (Jaarstad 2008 p.107).[5] Nonetheless, while not necessarily fully inclusionary, since it effectively guarantees executive representation for at least the most powerful groups, it is often seen as the only reasonable alternative –

[5] The concept has furthermore been stretched to include not only the sharing of political power, but also the division of territory, and military and economic resources (Hartzell & Hoddie 2003). Since the proposed mechanism under study concerns the political process, this dimension will be the sole focus of the study.

short of territorial separation – for a post-conflict settlement (Norris 2008 p.27). In this study, a minimum definition of Power-sharing is thus a *political system in which at least two distinct groups have guaranteed executive positions with mutual veto-rights*.

Hence, the very purpose of a Power-sharing agreement is to establish institutions which – intentionally – give rise to the sometimes contingent effects of veto players. Furthermore, it may be far more important than formal political institutions. Accordingly, and given the theoretical framework, the existence of power-sharing agreements, or the lack thereof, will reasonably be of importance for the state's ability to implement fiscal reform. Therefore:

> H2: *post-conflict countries with power-sharing agreements will mobilize lower levels of tax revenue during the recovery period.*

4 Research design and methodology

4.1 Mixed-methods design: Nested Analysis

Both the previous research on the empirical issue at hand, and much of the research which forms the basis of the operational theoretical framework for this thesis has distinct methodological approaches. The literature on post-conflict recovery and domestic revenue mobilization is dominated by single case studies with varying degrees of theoretical guidance, with the addition of occasional studies using descriptive statistics on a non-exhaustive sample of countries. Research on the relationship between political institutions and economic policy, meanwhile, has been characterized by a theoretical foundation of formal models, which is then tested using econometric methods.

By virtue of including large-N statistical analysis as well as small-n case studies, the present thesis can therefore potentially contribute to filling important gaps of knowledge in both fields of research. Most importantly, however, the choice of a mixed method research design is motivated by its inherent benefits for answering questions of causality.

In order not to be dragged into a philosophical quagmire, here it suffices to state that this study adheres to the assertion by George & Bennett (2005 p.12) that "causal mechanisms and causal effects are equally important to causal explanation". The argument for a mixed methods design, however, goes further than merely drawing the distinct benefits from each method separately. As Lieberman (2005) argues, by employing both methods simultaneously, the insights gained from one part may not only complement but also *improve* the results of the other.

Lieberman's *nested approach* provides a fairly concrete template for a research design. The essential feature of it is the dynamic relationship between its constituent parts. For the purpose of this study, this primarily means that the small-n case selection will be guided by the results of the large-N analysis.

In accordance with the generally accepted strength of statistical analysis, the purpose of the first step is to investigate the strength of a hypothesized correlation between variables of interest. The subsequent small-n analysis will in turn be primarily focused on unveiling the hypothesized causal chain.

4.2 Defining post-conflict recovery

The *universe of cases* to which this study applies – and for which the cases under study are "instances of" (George & Bennett 2005 p.69) – can be described as *public finance during post-conflict recovery*.

However, to delineate the precise scope of the study, the concept of *post-conflict recovery* has to be properly defined. This will first let us identify the *population* to which the study aims to generalize its findings; it will further provide the basis for the actual *sample* under study.

Post-conflict recovery is thus defined as a 15-year period following an armed conflict taking place on the territory of the country in question. Keeping in mind that "recovery" to some extent denotes a *political* process, rather than a mere cession of hostilities *per se*, the episode under study starts either in the last year of conflict (25 battle-related deaths or more), or when an effective peace-agreement is signed.

The above definition provides the relevant population for this study, and roughly translates into the actual sample being studied. Due to data availability and theoretical considerations, the sample will be restricted to recovery periods starting in 1989 or later. In a few cases where the start-date of recovery has been ambiguous (e.g. due to sporadic resumption of hostilities), it has been determined by identifying a breaking point in the GDP per capita trend.

For the purpose of transparency, all 34 cases are listed in Appendix I (Table A.I). It also includes a more thorough discussion of the above definition and the sample selection.

4.3 Large-N methodology

The statistical analysis will be carried out using OLS-regression with some additional specifications, using data compiled into an (unbalanced) time-series cross-section dataset, where every unit is a country-year. While having several potential benefits compared to a simple cross-sectional dataset, it also, however, opens up for statistical pitfalls (see e.g., Wilson & Butler 2007). Therefore, and given the character and quality of the data for the countries under study, the primary analyses will be OLS-regressions based on simple *country-averages*. Even though this does not reap the full theoretical potential of the original data, the advantage of having many original observations is still retained in so being that it produces more reliable *average* values for each country. The fact that every unit is a country (not country-year) it will also ease the interpretation of the results for the purpose of case selection. Finally, while the inclusion of a time-dimension in the analysis may help to infer *causality*, a simple cross-country regression may provide more robust evidence of *correlations.* Given the research design – where

causality is inferred from the combined results of both large-N and small-n analyses – the latter is the primary objective of the statistical analysis.

Despite the caveats, however, a regression based on the original time-series cross-sectional data will be used in two secondary models. These are primarily intended as robustness-checks of the cross-country-averages models, as the increase in observations allows for the inclusion of both independent variables in the same model. Here, one has to make sure that the additional observations really provide new information and that we are not merely artificially inflating the "degrees of freedom" (Wilson & Butler 2007 p.108). Indeed, with regard the dependent variable, much of the yearly values are expected to depend on the values for previous years rather than being fully determined by exogenous factors each year. In other words, a large portion of the additional observations Y_t can be predicted by Y_{t-1}. This problem of autocorrelation can be solved by controlling for Y_{t-1} in the regression, thus making sure that the inclusion of additional Y_t really represents new information. A lagged dependent variable will therefore be included on the right hand side of the regression equation when time-series cross-section data is used.

This lagged dependent variable-specification can also provide some additional information for causal inferences. This is so because it estimates the effect of X on Y, once the initial condition (or value of Y_{t-1}) is controlled for. In other words, it controls for country-specific unobserved factors which may affect both X and the initial level of Y (Wooldridge 2006 p.316). While it would be preferable to complement this with a *fixed-effects* model (Angrist & Pischke 2009 p.246) – i.e., estimating the effect of X on Y over time, within each country – this is not possible because of the low over-time variation in the independent variables.

Finally, since the recovery periods under study occurs during different time periods we have to control for secular trends in the data which may cause spurious results. A Year-variable is therefore introduced in all models. While this is not statistically the same as a time-fixed-effect it produces similar results provided that the "time-effect" is linear.[6]

4.4 Variable operationalization

The *dependent variable* is intended to capture the state's ability to mobilize domestic revenue. There are several important aspects to consider here. First, and as explained in the theory section we are interested in *domestic* revenue. Revenues like direct foreign aid or concessional loans are thus not of interest. Second,

[6] According to convention this is usually done by including time-dummies (i.e. one variable for every time-unit) in the model, since this allows for non-linear time-trends. This, however, decreases the "degrees of freedom" and produces tables that are difficult to interpret. Instead using a single continuous variable measuring years does not alter the results in the present models.

ability implies that revenues that can be conceived of as more or less automatic – or at least unrelated to political processes – such as natural resource rents should be excluded. Consequently, what is relevant for this study is *tax revenue*. Third, and directly given by the causal argument, *state* here denotes the *central government*, thus excluding revenues accruing to sub-state entities.[7] Naturally, for the figures to be comparable across countries, they are measured relative to GDP. The variable *Tax Ratio* is thus *central government tax revenue as percentage of GDP*.

While there are several potential sources for this data, they generally cover only certain regions and have serious missing data problems – especially for the countries under study in this thesis. However, the ICTD Government Revenue Dataset (Prichard *et al.* 2014), which will be used here, solves this by compiling revenue data from several sources (though mainly the IMF), while making sure it is comparable across countries.

The concept of *Veto Players* will be measured using data from the World Bank's Database of Political Institutions 2012 (Beck *et al.* 2001). Specifically, the variable "Checks" captures the concept of veto players as explicated above. In short, it is based on fairly simple rules counting the different chambers in presidential systems and coalition parties in parliamentary systems, while taking political alignments into account. Hence, it can take any discrete value starting from 1. In its original version, it has very few data gaps in the period of interest up to 2012 where it ends.

There is, however, one major validity problem: contrary to Tsebelis' assertion that the degree of democracy is irrelevant to the designation of veto players, Checks is always set to 1 – i.e., the lowest possible value – if the political system has a competitiveness score below a certain threshold (Keefer 2012 p.18).[8] The consideration given to competitiveness is likely to be especially problematic in post-conflict countries since competition is sometimes intentionally depressed in the initial phase.

When the variable is recoded to ignore the competitiveness criteria most of the observations that are effected turn into missing observations, and are thus excluded from analysis. This not only decreases the sample but could cause selection bias if the exclusion-principle is correlated with the dependent variable. Consequently, both the original Checks-variable and the re-coded version (henceforth referred to as Veto Players) will be used in the statistical analysis.

Data on Power-Sharing agreements are retrieved from the Peace Accords Matrix (Joshi *et al.* 2015), which includes data for 34 peace agreements from 1989 to 2012. If there is a provision for power-sharing the variable is coded as 1 and otherwise as 0. Since it only covers the first 10 years after a peace agreement,

[7] This is in line with e.g. Ricciuti (2004 p.375), but differs from many of the studies presented in the theoretical section.

[8] The alternative variable "CHECKS_LAX" relaxes the competitiveness criteria somewhat, but with preciously little real changes in the data.

the coding of year 10 has been extended to cover the whole recovery period as defined here.

In addition to the aforementioned independent and dependent variables, a couple of *control variables* will naturally have to be included in order to replicate the *ceteris paribus* condition and avoid omitted variable bias.

As evident from the very wide definition of armed conflict specified above, the character and especially the disruptive effect of the included conflicts varies significantly within the sample. Naturally, this will have repercussions for the economic outcomes during the recovery period. It is also plausible that the intensity of the conflict will affect the post-conflict political arrangements. Hence, an indicator of relative conflict magnitude is constructed and included in the statistical models. It consists of the cumulative battle-related deaths in the 10 last years of conflict, divided by the population size (measured in units of 1.000) at the end of the conflict.

Battle-related deaths are primarily based on data from Uppsala Conflict Data Program.[9] But since the UCDP Battle-Related Deaths Dataset (v.5-2015) only covers the years between 1989 and 2014, it has been complemented, when necessary, with data from PRIO Battle Deaths Dataset 3.0 (Lacina & Gleditsch 2005). Population data are taken from the World Bank (2016).

As noted, the literature on liberal peacebuilding tends to focus on the influence of external actors in shaping economic (and political) outcomes. The most prominent international actor when it comes to fiscal policies is without doubt the IMF. With regard to fiscal policy in developing states, the IMF has actually promoted the collection of *higher* tax revenues (Fjeldstad & Moore 2008 p.239). At the same time, preferences do not necessarily translate into outcomes. As pointed out by Tsebelis (2002 p.35f.) actors like the IMF can function as veto players and therefore (inadvertently) cause policy inertia. This all the more likely since the IMF not only promotes tax collection, but very particular fiscal reforms with distributive consequences (e.g. preferring sales taxes to trade taxes). Thus, while it is clear that IMF conditionality does have an effect on tax reform (Mahon 2004), it is not clear whether the effect is positive or negative for the *level of tax revenue*.

The variable measuring IMF conditionality is based on data from Dreher *et al.* (2015), recording basic information on all IMF agreements signed between 1992 and 2008. From this, a dummy-variable has been constructed, taking the value of 1 when an IMF-agreement is in place and 0 otherwise. Since the longest agreements span over a period of 4 years, the last observations are found in 2012.

Note, however, that countries which *already have* fiscal problems (i.e., low revenue) will often actively request IMF engagement; they may also "select-in" to IMF-agreements because the political leadership *plans* to initiate economic

[9] Since the data are structured according to either *conflict* or *conflict-dyad*, and the unit of analysis for this study is *countries*, the actual source used is the World Bank's (2016) World Development Indicators. The variable "Battle related deaths (number of people)" is directly based on UCDP's Battle-Related Deaths Dataset, but arranged according to country-years.

reforms which are unpopular, and therefore seeks political support from the IMF (Vreeland 2003). To avoid incidences of reversed causality the IMF-dummy will be introduced with a lag of 5 years in the time-series cross-section models.

Though it is certainly a contentious issue, the demographic *fractionalization* is often assumed to be a salient factor in (civil) wars. Moreover, influential studies have argued that it has adverse effects on both political institutions and macro-economic outcomes (see e.g. Easterly & Levin 1997). We therefore need to control for the possibility that the assumed causal relationship between veto power and fiscal outcomes is not in fact spurious and driven by a simultaneous effect of demographic fractionalization.

The best available data – much improved compared to previous sources – comes from Alesina *et al.* (2003), which includes separate indices for ethnic, religious and linguistic fractionalization. The demographic fractionalization variable used in this study is simply the mean of these indices for each country. The variable can take any value from 0 to 1.

Proceeding with economic factors, *GDP per capita* is included since it probably predicts much of the variance in the tax level, even if it does not covary with the independent variables. Data for GDP per capita are retrieved from the World Bank (2016) and measured in constant 2005 USD.

Furthermore, it is reasonable that easily extracted revenues from for example natural resources decrease the incentive for politicians to devote energy to the tedious business of collecting taxes. Non-tax revenues should therefore have a negative effect on the tax revenue level. It is also argued that large flows of non-tax revenue affect the political institutions; as well as the incidence, character and outcome of armed conflict (see e.g. Kaldor *et al.* 2007 on oil rents).

In addition to domestic non-tax revenues, post-conflict countries typically receive substantial amounts of foreign aid. Though the effect of foreign aid on tax revenue is far from settled (Prichard *et al.* 2012 p.13f), and arguably depends on both domestic conditions and the character of aid, several studies have found that it has a negative effect on the tax effort (e.g. Bräutigam & Knack 2004; Remmer 2004). A variable measuring foreign grants will therefore be included in the statistical analysis.

Data for both variables comes from the ICTD Government Revenue Dataset (Prichard *et al.* 2014), and is measured in relation to GDP.

A summary of all variables and basic descriptive statistics of the data can be found in Table A.II in Appendix II.

4.5 Case selection strategy

The selection of cases for the small-n analysis will be based on how well they are predicted by the statistical models (Lieberman 2005 p.444). This strategy of selecting "good cases" is criticized by Fearon & Laitin (2008 p.762) since it purportedly (1) provides little new information and (2) may be subject to selection bias or the fallacy of testing a theory on the empirical data which gave rise to it in

the first place. These problems can be mitigated by using random selection (*ibid.* p.765f.) or selecting solely on the independent variable (King *et al.* 1994 p.140f.).

However, in addition to the inefficiency of truly random selection given a small number of cases (Gerring & Seawright 2008 p.295), the benefits of the latter strategies in terms of validating the *causal effects*, comes at the price of decreased ability to evaluate the proposed *causal mechanism.* In a mixed method research design, such strategies are primarily justifiable given a deterministic notion of causality (cf. Hollis 1994 p.12f.). In essence, they strive to answer *whether the hypothesized causal mechanism is present in the randomly chosen case X*. Since we are already likely to know from the large-N analysis that some cases *fail to show the expected correlation*, we also know that the very same cases will not exhibit the proposed *causal mechanism*. Hence, in-depth studying of *these* cases will add no further information; we already know that the mechanism is not operational.

In essence, the argument above hinges on the assumption of the probabilistic nature of social science theory. As Lieberman (2005 p.444) points out, when deciding to choose cases "on the line" (i.e., that fits the model) we have already decided that "cases outside of the confidence interval are not of theoretical interest and should be treated as unexplained 'noice'". The purpose of the small-n analysis is not to improve the predictive capacity of the model, but rather to investigate the hypothesized causal process of a model that *on average*, explains *some of the variance* of the dependent variable.

Therefore, two cases will be selected on the basis of their closeness to the regression line, and with the aim of having as much variance on the independent variables as possible between them. Given the character of the population and phenomena under study, some consideration also has to be given to data availability. For the sake of selection transparency, the main regression result will be graphically presented in a scatter plot, with the full sample of countries included.

4.6 Small-n methodology

The main benefit of carefully analyzing a small number of cases is the possibility of differentiating between rival causal mechanisms (Gerring 2004 p.347; Golden 2005 p.6). While having fewer units under analysis compared to a statistical analysis, cases studies allow for an expansion of the number of observations *within* each unit.

Accordingly, the case studies will be conducted using a process-tracing methodology, the aim of which is to "identify the intervening causal process – the causal chain and the causal mechanism – between an independent variable (or variables) and the outcome of the dependent variable" (George & Bennett 2005 p.206). With regard to investigating causal explanations, the strength of this method – besides the additional observations it provides – is that the observations

"must be linked in particular ways to constitute an explanation of the case" (*ibid.* p.207). Concretely, *all* intermediate steps – as implied by the theory – must be empirically validated for the causal mechanism to be considered confirmed.

While methodologically distinct from comparative approaches, the decision to focus on process-tracing does not preclude comparisons between cases. Therefore, by virtue of selecting two cases, possible confounding factors that have not been repudiated in the large-N analysis can potentially be ruled out by keeping these factors constant. By structuring the analysis through a set of theoretically derived questions which are posited to the empirical material, the analyses of the separate cases will be comparable and can thus form the basis for inferences (*ibid.* p.86). It must be reemphasized however, that the primary task of the case studies is to unveil the causal mechanism, *not* to infer correlation by eliminating confounding factors – the latter of which is generally more efficiently conducted in a statistical analysis.

4.7 Case study structure and qualitative indicators

While the statistical analysis deals with the two end-points of the assumed causal chain, for the purpose of the case study the process under study can be divided into two analytical stages: the first of which concerns the effect of the political structure on policy inertia, the second focuses on the link between policy inertia and outcomes in terms of tax ratio.

With regard to the first stage, it is assumed that veto powers will cause policy inertia. But there are two major alternative explanations that need to be controlled for: a lack of *need* and a lack of *will* for policy change. Both are extremely difficult to control for in a statistical analysis (although the BRD Index partly intends to capture the *need*). Some focus will therefore be given to these factors in the case studies. The *need* for policy change will be assessed first by gauging the damage caused by the preceding conflict, the structure of the economy at the start of the recovery period, and the quality of the existing tax system. In addition, the opinions of the IMF will be considered an indicator. While their statements can be deemed subjective and indeed biased, importantly, such a bias will not vary between the cases. Furthermore, by virtue of the IMF's power, their subjective assessments to some extent translate into *objective incentives*, and thus *need* for policy change. Second, *political will* is to be evaluated by statements and plans issued by the domestic political leadership.

The last analytical step in the first stage is to measure policy inertia. As touched upon in the theory section, this is not simply an exercise of counting the number of laws or actually implemented policies: indeed policy inertia is theoretically and empirically associated with the passing of *more* albeit insignificant laws. Hence, following Tsebelis (2002 p.180ff.) who distinguishes between significant and non-significant laws, the operationalization of policy inertia is based on three categories of tax revisions. First, *minor adjustments*

denote moderate changes in already existing tax laws, concerning e.g. rates, the number of brackets or administrative rules. *Major adjustments* likewise concerns existing laws but entail large nominal changes and significant revenue effects.[10] Lastly, *major reforms*, are established by completely new laws and imply a revision (or establishment) of a complete category of taxes or a total overhaul of the tax administration.

The choice of three categories is justified mainly by two considerations: the theoretical dynamic of policy inertia and the expected revenue outcomes of these reforms. First, while *adjustments* – minor or major – are typically one-dimensional issues, a *major reform* is multi-dimensional (see p.9, above). The latter category is therefore more likely to be affected by the number actors with veto powers. However, it is also recognized that an essentially one-dimensional (albeit *major*) *adjustment*, at least in the short term can result in significant changes in revenue and cost-distribution. The political costs for accepting such a non-preferred change is therefore high. Hence, not only can it affect the tax ratio, but is also an indication of a lower policy inertia.

In sum, the three categories represent an ordinal scale, whereby minor adjustments are fully compatible with policy inertia and major adjustments indicate somewhat lower policy inertia. Major reforms in turn are expected to be extremely rare in political systems with strong veto powers.

As is denoted in the term itself, and as emphasized in the War of Attrition model (Alesina & Drazen 1991), the policy outcome need not be binary (or triadic), but can be described in terms of *time*. In other words, policy inertia does indeed allow for *major reforms*, but it will take longer time to proceed from the point where the need for change first arises, to that of actual policy implementation. Consequently policy inertia is indicated both by the number of major adjustments and reforms, *and* the time it takes for them to be implemented.

It is worth reemphasizing that while between-case comparisons of the outcome in terms of tax reforms is possible in this first step in the causal chain, the primary purpose is to trace the causal process – from policy proposals to the possible implementation of a reform – *within each case*.

The second analytical step in the case studies will be to elucidate the relationship between the implemented tax policies (or lack thereof) and the outcome in actual tax ratio. As has been explained at length above, in addition to the political factor of interest there is a variety of economic factors which will influence the level of tax revenues. While these must be taken into account *within* each case, it will be impossible to keep them constant *between* the cases – again, this is instead the comparative advantage of the large-N analysis. Consequently the second stage of the case studies must be fully dedicated to *within-case comparison*. Concretely this implies investigating the temporal relation between policy implementation and tax revenue outcome, while taking other alternative factors into account.

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[10] E.g., it would apply to a 50% increased gasoline tax (but not a 100% increase in the tax on post-stamps).

The case studies are based on both first- and second-hand sources. In addition to some basic statistical data, the first hand sources are composed of peace agreements and some legal documents, as well as minutes of IMF consultation meetings, Staff Reports expressing the opinion of the IMF "experts", and related documents. These internal IMF documents – in total around 30 for each case study – also constitute a valuable second-hand source for information on planned and implemented policies, and their fiscal outcomes. In addition, a variety of second-hand sources is used, including: articles in newspapers, periodicals and academic journals; books, reports and working papers; and finally miscellaneous documents issued by the concerned governments.

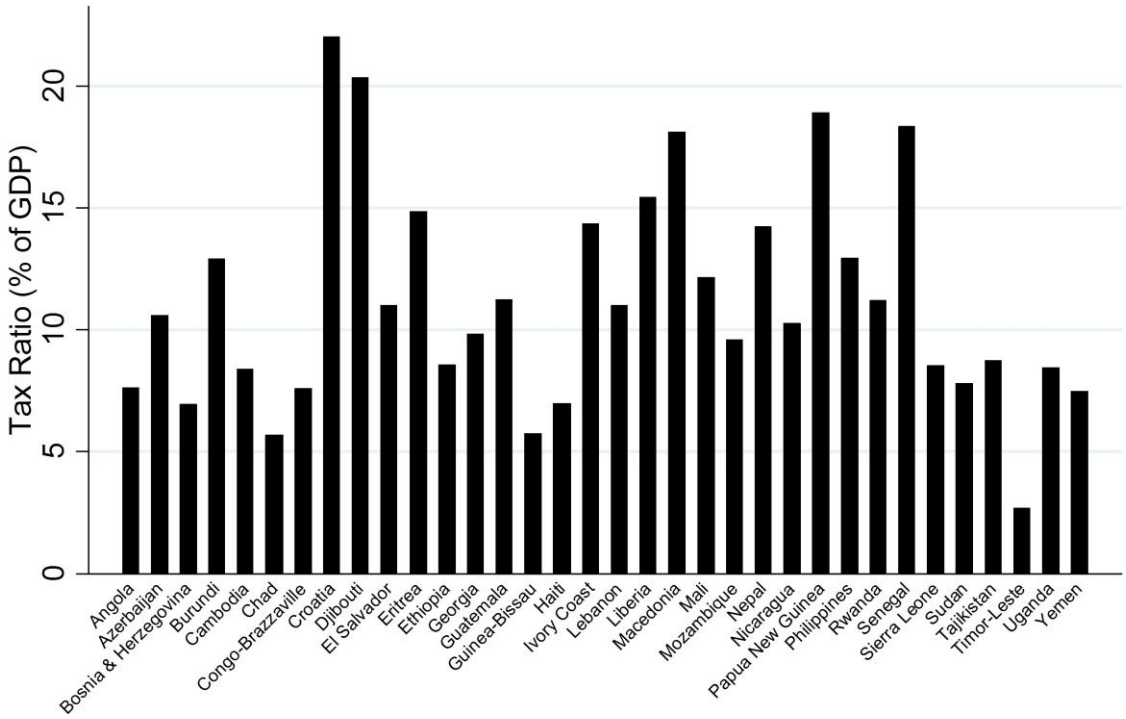
5 Statistical analysis

5.1 Results of the regression models

According to the causal argument (see Figure 1), we expect that both the number of veto players and the existence of a power-sharing agreement affects the tax ratio. Figure 3 shows that there is considerable cross-country variation in tax revenues in the 34-country sample. This section aims to investigate how much of this variation that can be accounted for by the independent variables of interest. It is guided by the following two hypotheses:

> H1: *post-conflict counties with more veto players will mobilize lower levels of tax revenue during the recovery period.*
>
> H2: *post-conflict countries with power-sharing agreements will mobilize lower levels of tax revenue during the recovery period.*

Figure 3. Average tax ratio by country



Source: ICTD Government Revenue Dataset (Prichard et al. *2014).*

Table 1 presents the results of five regression models with tax ratio as their dependent variable. The first three models are OLS-regressions on *country averages* for all variables. Since, with this simple cross-section data, the observations drop to just over 30 (out of a maximum of 34), it provides very conservative results. As discussed in the methodology section (4.3), however, it also mitigates several statistical problems arising with time-series cross-section data which are difficult to overcome given the quality of the data at hand. The interpretation of the variables when converted to their country-mean is in most cases straight-forward. Nonetheless one should note that the indices of battle-related deaths and fractionalization are unchanged since they were constants in the original data. The IMF-variable – originally a dummy – now reflects the fraction of the period under study when an IMF-agreement has been in place. Finally, even though there is no need to control for secular data trends *within* the countries given the data structure, since the recovery periods are not simultaneous, there might be unobserved time-trends which drive the cross-country differences. A Year variable is thus included, representing the time at which exactly half the recovery period has elapsed.

Model 1 includes the original Checks variable from the World Bank in addition to all control variables. While the coefficient is positive, it is far from statistically significant.

In Model 2 the re-coded Veto Player variable is used instead. Despite the low number of observations (31) the coefficient is statistically significant (p=0.019), but with a surprising *positive* sign. It indicates that for every additional veto player the average tax ratio *increases* with around 1.2 percentage points.

Model 3 instead introduces the Power-Sharing variable; it is also statistically significant (p=0.016), and importantly has a fairly large coefficient with the expected sign. It suggests that the marginal effect of establishing a power-sharing agreement is a decrease of the average tax ratio with 3.6 percentage points.

The estimators for the control variables are similar in the above models. Neither indices, nor the IMF-indicator are significant. Furthermore, aid flows, as captured by the Grants variable, does not seem to affect the tax ratio in either way. However, as expected, GDP per capita has a positive effect on the tax ratio while non-tax revenue decreases it. The positive coefficient for the Year variable indicates that there is a positive trend in the dependent variable which is not captured by the other control variables. The first model can account for half of the variance in the dependent variable; in models 2 and 3, R^2 increases to 0.67 and 0.57 respectively. In sum, with the relevant confounding factors accounted for, while veto players as measured by the original Checks-variable has no apparent effect on the tax ratio, the recoded variable shows a significant positive effect, which seems to disconfirm hypothesis 1. Power-sharing on the other hand has a strong correlation with a lower tax ratio, thus lending support to hypothesis 2.

The apparent effects of Veto Players and Power-Sharing are fairly similar in magnitude: a one standard deviation increase of Veto Players is correlated with a rise in the level of taxes with (1.22*1.18=) 1.4 percentage points; the equivalent for Power-Sharing is a (0.50*3.60=) 1.8 percentage point decrease.

Table 1. OLS-regression on Tax Ratio

	Aggregated Cross-Section Data			**Panel Data**	
	(1)	**(2)**	**(3)**	**(4)**	**(5)**
Checks	0.74			0.03	
	(0.56)			(0.06)	
Veto Players		**1.18***			0.04
		(0.47)			(0.09)
Power-Sharing			**-3.60***	**-0.63****	**-0.66***
			(1.38)	(0.23)	(0.25)
GDP/Capita	**1.17***	**1.18****	**1.17****	-0.05	-0.04
	(0.45)	(0.36)	(0.41)	(0.06)	(0.07)
Fractionalization	-5.29	-5.57	-4.66	**-1.05***	-1.05
	(3.94)	(3.12)	(3.59)	(0.51)	(0.59)
BRD Index	0.99	0.15	1.01	**0.59****	**0.49***
	(1.73)	(1.52)	(1.55)	(0.19)	(0.21)
IMF Program	1.98	4.84	0.23	-0.14	-0.10
	(4.01)	(3.29)	(3.67)	(0.19)	(0.21)
Non-Tax Revenue	**-0.18***	**-0.17***	**-0.26****	**-0.03*****	**-0.03****
	(0.08)	(0.06)	(0.07)	(0.01)	(0.01)
Grants	0.03	-0.15	0.02	0.01	0.01
	(0.25)	(0.20)	(0.22)	(0.03)	(0.03)
Year	0.58	**0.62***	**0.66***	**0.12*****	**0.13*****
	(0.30)	(0.24)	(0.28)	(0.03)	(0.03)
Tax Ratio$_{t-1}$				**0.91*****	**0.90*****
				(0.03)	(0.04)
Constant	-1144.70	-1236.49*	-1310.42*	-243.40***	-261.03***
	(600.75)	(486.59)	(554.93)	(54.41)	(60.43)
Observations	33	31	33	194	173
R^2	0.50	0.67	0.58	0.94	0.93
p-value	0.02	0.00	0.00	0.00	0.00

*Standard errors in parentheses; * p < 0.05, ** p < 0.01, *** p < 0.001; Significant estimators marked in **bold**. Independent variable is central government tax ratio. Model 1-3 are OLS-regressions on 15-year country-means. Models 4-5 are based on the original time-series cross-section data and include a lagged dependent variable; IMF Program is lagged 5 years.*

Because of the low number of observation, the estimates for both independent variables turns insignificant when entered into the same cross-section regression (not reported). Model 4 and 5, however, includes Checks and Veto Players, respectively, together with Power-Sharing, in an OLS-regression based on the original time-series cross-section data. This expands the number of observations by a factor of around six. However, as expected, the data in these models suffer

from serious autocorrelation.[11] To guard against artificially inflating the observations of values that are closely temporally correlated, a lagged dependent variable is thus introduced in the regression. The Year variable is included to replicate a time-fixed-effects model, thus controlling for an unobserved (linear) time-trend. The IMF variable (now a dummy) has a lag of 5 years – which, while decreasing the number of observations, captures a plausible delayed effect.

In Model 4 the coefficient for Checks is very small and non-significant, thus in line with Model 1. The coefficient for Power-Sharing is likewise drastically reduced but has a very high significance. This decrease in the magnitude of the estimator is largely because of the introduction of the lagged dependent variable; instead of merely estimating the average yearly effect, the model does so while taking the value of the previous year into account. The significant and large coefficient on the lagged dependent variable indicates that the current value of Tax Ratio is indeed highly correlated with that of the previous year. The model can thus be interpreted as such: *given a certain tax ratio* in one year – and controlling for other relevant factors – the establishment of a power-sharing agreement will *lower the tax ratio in the subsequent year* by around 0.7 percentage points.

Model 5 switches from the original Checks-variable to the re-coded Veto Player-variable while retaining Power-Sharing. The latter has a similar negative coefficient (-0.66) to Model 4, albeit with a slightly lower significance. As opposed to Model 2, however, the coefficient for Veto Players is far from statistically significant. Hence, given a specific tax ratio in the present year, the addition of a veto player will *not* significantly affect the tax ratio in the next year.

Most control variables have a similar but reduced coefficient in these last two models. While the results of Model 4 and 5 should be interpreted cautiously in and of themselves, they do provide additional support for a hypothesized causal effect of power-sharing on tax revenues.

In line with the WoA model (and H2), Model 3, 4 and 5 taken together provides firm support for the fact that power-sharing agreements depress the recovery in tax revenue. The results for veto players are more mixed. While the original Checks-variable failed to enter significantly in any model, the adjusted Veto Player variable did so in Model 3. When entered into a dynamic model (5) however, the coefficient becomes minute and is no way near statistical significance. This indicates that even though post-conflict countries with many veto players (surprisingly enough) do indeed have higher average tax ratios (when controlling for confounding factors) – this relationship is not necessarily causal. When we take into account the present tax ratio, additional veto players do not increase (or decrease) future tax ratios. Consequently, H1 is not verified by the above results.

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[11] Specifically, Wooldridge's (2002) test for autocorrelation in panel-data is performed (not reported).

5.2 Interpretation of the statistical results

Based on the causal model presented in chapter 3, we expect that the political structure will affect the state's ability to adjust fiscal policy to new circumstances. In the context of post-conflict recovery, this specifically means that veto players and power-sharing will both cause policy inertia. In a context of economic recovery and low initial tax revenues, this would lead to lower tax ratios.

The results of Table 1 showed consistent support for the hypothesis that power-sharing agreement does indeed depress the tax ratio. Not only do countries with power-sharing agreements on average have lower tax revenues when keeping other factors constant, but it also has a negative effect on this year's tax revenues when the initial (*t*-1) level is accounted for. With regard to hypothesis 2, we not only have a strong empirical correlation, but some support for causality.

On the other hand, the results also *disconfirmed* hypothesis 1: depending on the operationalization, veto players either had no significant correlation with tax ratios (Model 1) or was in fact associated with higher average tax ratios (Model 2). But when – as in Model 5 – the fact that tax ratios for adjacent years are highly correlated was taken into account, the effect of veto players disappears altogether. The most plausible interpretation is that some unobserved condition, not included in the models, leads to both higher tax revenues and more veto players. Hence, countries with many veto players may start off their recovery period with high tax revenues, but given this high initial level additional veto players do not increase it – indeed do not affect it much at all. Hence, the conclusion would be that veto players do not cause policy inertia (and low tax revenue) in post-conflict countries.

Still, given the complete lack of significant results for the original Checks-variable, the above interpretation is rather speculative. Indeed, as noted in the methodology section: what was gained in terms of theoretical validity by the re-coding of the Checks-variable may be lost in terms of reliability due to the resulting missing observations. Thus, the alternative interpretation is that the indicators used this far are invalid (in post-conflict countries) and is therefore not really measuring the number of actors capable of vetoing a decision.

In line with the purpose of the research design, the priority of the proceeding case studies must be to investigate the causal mechanism of the correlation which has indeed been established in the statistical analysis. Concretely, this means carefully examining whether and how power-sharing agreements cause policy inertia and how this in turn translates into lower levels of tax revenue.

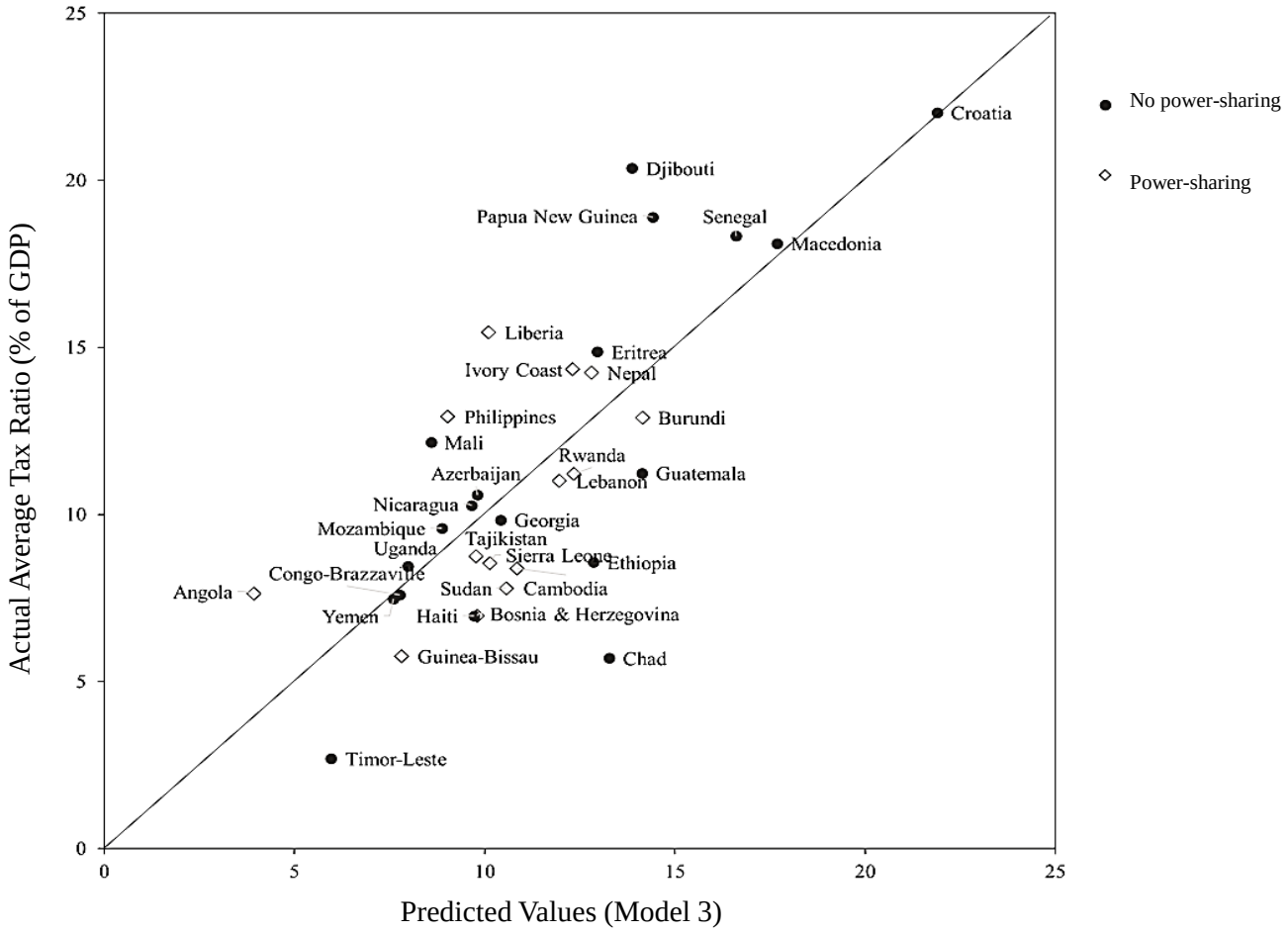
Regarding veto players, there is no apparent causal mechanism to examine, since the statistical results have not been able to show any correlation in line with the hypothesized mechanism. Consequently, the first step must be to scrutinize the validity of the variable as operationalized here. By comparing the values of the data used in the statistical analysis with a careful application of the veto player concept in the case-studies, the validity of the hitherto used operationalizations can be judged, and by extension what conclusions to draw from the statistical analysis.

6 Case study section

6.1 Case selection

Figure 4 plots the predicted values for each of the 33 countries included in Model 3 (based on country averages and including Power-Sharing), against their actual average tax ratio. The line indicates where the predicted values match the actual values, i.e, were each country would line up if the model were 100% accurate. Countries with power-sharing agreement are marked as squares, the remaining as filled circles.

Figure 4. Predicted vs. actual tax ratio



Note that a close fit to the line obviously tells us nothing about the causal mechanism at work – indeed it only means that the average tax ratio for that particular country is *well predicted by the model as a whole*. The goodness of fit for a specific country may therefore not be due to the presence or lack of a power-sharing agreement, but rather other factors included in the model. Indeed, as evident from the statistical results, power-sharing only explains a minor portion of the variance in tax ratio – were it otherwise, all power-sharing countries would be found in the bottom-left quadrant in Figure 4.

Hence, a good fit to the line does not tell us anything about the specific correlation between power-sharing and tax ratio for *that particular country*; but a good over-all fit increase the *likelihood* that the assumed causal mechanism is in fact present.

Many of the otherwise possible candidates close to the line are excluded on the basis of lacking data availability, leaving just a couple of alternatives.

The choice of Uganda and Lebanon is based on the considerations outlined above. The pair shows variation on the independent variables of interest (power-sharing as well as veto players), and despite being very different they are comparable with regard to both the initial *need* for reform and general *political will*; both experienced protracted and extremely destructive wars prior to recovery, and both have had reform-minded political elites.

6.2 Uganda 1992-2006

6.2.1 Background

The rule of Idi Amin in the 1970's was characterized by political repression and large-scale violence, as well as economic disruption. With backing from neighboring Tanzania, previous president Obote finally ousted Amin in 1979 and reclaimed the presidential power through elections a year later. But a break-away faction of Obote's rebel army, the National Resistance Movement (NRM), led by Yuweri Museveni, soon turned their weapons against their former ally, overtaking Kampala in 1986.

Due to the political repression, later escalating into armed conflict, the economy of Uganda almost collapsed between 1970 and 1986, with a GDP per capita drop of 40% and large sections of the population reverting to subsistence farming (Collier & Reinikka 2001 p.19f.). Moreover, by 1986 around 60% of the private wealth of Ugandans was held aborad (*ibid.* p.28).

While the NRM's assumption of power marked the beginning of a period of political continuity, various rebel groups continued their struggles against the central government, leading to many hundreds of deaths each year. Nonetheless,

the aggregated conflict intensity dropped dramatically in 1992, after which there have been sporadic eruptions of violence (for a detailed account, see UCDP 2016). This year also marked the start of an ambitious Disarmament, Demobilization and Reintegration (DDR) program (Ndikumana & Nannyonjo 2007 p.39), indicating a political effort aimed towards recovery rather than continued conflict.

6.2.2 Political structure

According to the World Bank's Database of Political Institutions (2012), Uganda had only one veto player for the duration of the period under study (as defined by "Checks"). The adjusted Veto Player variable is missing for most years, but likewise has the value of 1 for non-missing years.

The political system brought about by the NRM was influenced by the ideas of ethnic unity and local grass-roots participation. Hence, political parties were in practice banned; instead, a system of participation through *individual* competition was constructed (Carbone 2001 p.56). The NRM – the "movement", not the "party" n.b. – thus became the only functioning political organization.

From 1986 and onwards, the president – who appoints the cabinet – has been elected via direct elections. Museveni received 73% and 69% of the votes in 1996 and 2001 respectively (Ugandan Electoral Commission 1996; 2001). It was not until 1994, however, that a parliament was elected. Because of the party-ban it is difficult to ascertain the parliamentary support for the president, but it was initially estimated to be between half and two thirds of the delegates (Carbone 2001 p.61). When parties were officially allowed to participate in the elections in 2006, the ruling NRM got 66% of the parliament seats (Gloppen *et al.* 2006 p.5).

The lack of any formal party association bars the parliament from being counted as a veto player according to the DPI operationalization (see Keefer 2012) – and indeed makes it practically difficult for it to act as a veto player in real terms as well. While one can note that MP's did actually manage to form informal parliamentary alliances, by which considerable opposition to economic reforms was staged (Keating 2011), this opposition fell short of a veto-wielding power.

Furthermore, despite the enormous size of the cabinet, amounting to 67 seats in 2001, it has worked more as a vehicle for patronage than an area for the exercise of veto power (Mwenda & Tangri 2005 p.459). The assignment of one single veto player in Uganda is accordingly correct.

For the period under study, there are two distinct internal peace agreements to which the government was a party. As is evident by the above account, however, these did not entail any political power-sharing provisions. Both the Gulu Peace Accord (1988) and the Yumbe Peace Agreement (2002) included provisions for reintegration of former combatants as well as reconstruction and economic support for the conflict-affected regions. The political provisions were, however, vague and in spite of explicit demands by one of the rebel groups (UNRF II) that the agreement should provide for at least one ministerial position for them (BBC

2002), no explicit political provisions, let alone power-sharing provisions, were included in either of the final agreements.

Hence, while being continuously plagued by different rebel groups in the country, and indeed agreeing to settlements at two occasions, Museveni was careful not to restrain his political power by establishing power-sharing agreements.

6.2.3 Fiscal reform

In the initial years of NRM's rule, the public finances remained in a poor state (Henstridge & Kasekende 2001 p.56). But with a drastically improved security situation coupled with an unexpected shortfall in revenues in 1991/92 the first years of the 1990's became a turning point. It subsequently became a priority to reform the tax system, which by IMF experts at the time was deemed to be "among the world's weakest" (IMF Staff Report 1992 p.18). First discussed in 1990, the new and independent Ugandan Revenue Authority (URA) became operational ahead of schedule in 1992 (IMF Background Paper 1997 p.40) and was given the ambitious goal of increasing revenues by 1% of GDP annually in the coming years. Its independence towards the Ministry of Finance and the executive, as well as an extremely well-paid staff compared to other public agencies, initially contributed to a high level of effectiveness. Towards the end of the decade, however, stagnating salaries and a general lack of public support from the executive – sometimes amounting to hostility – led to more corruption and negative public perceptions (Therkildsen 2004).

Since the 1970's Uganda had been heavily reliant on export taxes, especially on coffee, which had constituted almost half of total revenues (Cawley & Zake 2009 p.106). In the first few years of the 1990's, however, the structure of trade taxes went through radical reforms. Export taxes were almost completely abandoned and substituted by import taxes, mainly on primary commodities. Initially, the tariffs were highly differentiated – ranging from 10 to 350% – but were later brought down to more uniform and considerably lower levels. The reforms meant that instead of coffee exports, petroleum imports now constituted the main revenue source for the government (Chen *et al.* 2001 p.276). In addition to revisions of import taxes, the budget of 93/94 included tax reforms concerning personal income, real estate, corporate earnings, and consumption taxes, as well as improvements in tax administration (IMF Staff Report 1993a p.8f).

One illustrative example of the resolve and policy flexibility of the Ugandan government around this time is the temporary reintroduction of the coffee export tax in 1994. When Brazilian coffee plantations were hit by frost in June 1994, it was anticipated that the resulting increase in world market prices would more than double the value of Ugandan coffee exports that same year. In July, the government announced that a temporary graduated export tax on coffee would be effective as of August 1st. The decision was met with fierce criticism from coffee producers, but after conceding to some minor changes, the tax was introduced on October 1st (IMF Staff Report 1995 p.28). When the two-year price boom was

over, it was abolished. Interestingly, the tax was not introduced in order to increase revenues for running expenditures – however badly needed – but to keep the excess foreign currency inflows from causing an appreciation of the local currency, which would have harmed other export sectors (Henstridge & Kasekende 2001 p.69).

The second large tax reform occurred in 1996 – having first been presented to the IMF in 1994 (IMF Policy Framework 1994 p.4) – and just like in the case of trade taxes, this reform was intended to simply replace the revenues from the old sales-tax with those of a new value-added tax (VAT). In the presidential election the same year, this issue became a focal point of contention, with the main presidential contender arguing that the tax would affect ordinary Ugandans negatively. Museveni on his part claimed that it would only affect the largest companies (Therkildsen 2004 p.81).

In spite of public concerns and criticism from parliament, the new VAT was quickly implemented after Museveni won the election, i.e., a mere two years after it was first suggested. Seen from an international perspective at the time, this was not an unusual reform: indeed it represented one of the crucial policy recommendations on behalf of the IMF, and was consequently adopted by a wide range of developing countries under its tutelage. However, while most countries detracted from IMF-recommendations by setting considerably lower thresholds for VAT payments (i.e, forcing smaller companies to pay VAT, thereby increasing revenue, but according to the IMF imposing "distortionary" burdens on small-scale business), the Ugandan government set the threshold precisely in accordance with that proscribed by the IMF (Ebrill *et al.* 2001 p.114).

Despite the fairly modest VAT-rate of 17% – intended to simply replace the revenue stream from the old sales tax – a massive non-compliance action was organized by small-traders affected by the VAT reform. While Museveni went out publicly in defense of the reform, stating that it will not be reversed, the Ministry of Finance started negotiations to appease critical parliamentarians. The latter demanded an increase of the already high threshold of 20 million Ugandan shillings to 150, but finally settled for 50 million (47,000 USD) (Cawley & Zake 2009 p.110; Therkildsen 2004 p.79). As a consequence, the protests were soon called off and the new threshold was implemented in November 1996. The adjustment notwithstanding, the effectiveness of the reforms were initially severely hindered by active evasion and complicated administrative regulations (IMF Background Paper 1998 p.4). However, in the first few years after its implementation the revenues from VAT reached parity with the previous sales-tax (Ebrill *et al.* 2001 p.26).

At the same time, attention was also turned to the outdated and haphazardly reformed income tax law of 1974, whose complexity and many exemptions resulted in minimal revenue flows (Cawley & Zake 2009 p.113). The main purpose of the reform, however, was not to increase revenues *per se* but rather to achieve a broader tax base, simplify administrative procedures and promote investment (Chen *et al.* 2001 p.277). While the government seems to have had the audacious ambition to implement the new Income Tax Act a mere couple of months after the drafting process was initiated (IMF Policy Framework 1995

p.11), it was delayed for a year and finally implemented in July 1997 (IMF Policy Framework 1997 p.5).

Having essentially completely revised the (central) tax system in the first five years of the recovery period, tax policy reform stagnated after the implementation of the new income tax. The reforms that were actually made mostly concerned exemptions and minor rate adjustments of the VAT and income taxes (see e.g., African Development Bank 2011 p.286f.).[12]

The development was not, however, due to any inadvertent policy inertia but seems to reflect a strategic stance by the Ugandan government regarding economic policy. Indeed the government explicitly opposed recommendations from the IMF to implement further tax policy reforms aimed at increasing domestic revenue; instead, it decided to focus fully on improving the tax administration (see IMF Country Report 2003 p.10, 20; IMF Country Report 2005 p.16). The fact that the government did not pay lip service to the IMF by issuing tenuous promises of policy reform, but rather outright rejected the option despite facing harsh critique is telling. Arguably, it indicates that halt in the fiscal reform process was shaped by a well-defined strategy rather than domestic political gridlock.

In sum, as Whitworth & Williamson (2009 p.35) notes, the whole economic reform process in Uganda can be described as directed by a few individuals with Museveni in full command: "As long as the minister [of Finance] and permanent secretary were convinced, since they were known to have strong Presidential support, there was little need to persuade anyone else".

6.2.4 Tax structure

Figure 5 shows the total flows of central government revenues as a percentage of GDP, as well as tax revenues and the fraction of which is constituted by indirect taxes. Tax revenues increased dramatically in the first years of recovery, from just above 5% in 1992 to around 9% in 1996; and given the rapid GDP growth at this time, represented an even larger increase in absolute terms. Notable is that most of this growth can be attributed to indirect taxes, such as the swiftly reformed trade taxes. After 1999 this development was reversed, reflecting larger revenue flows from the reformed income tax.

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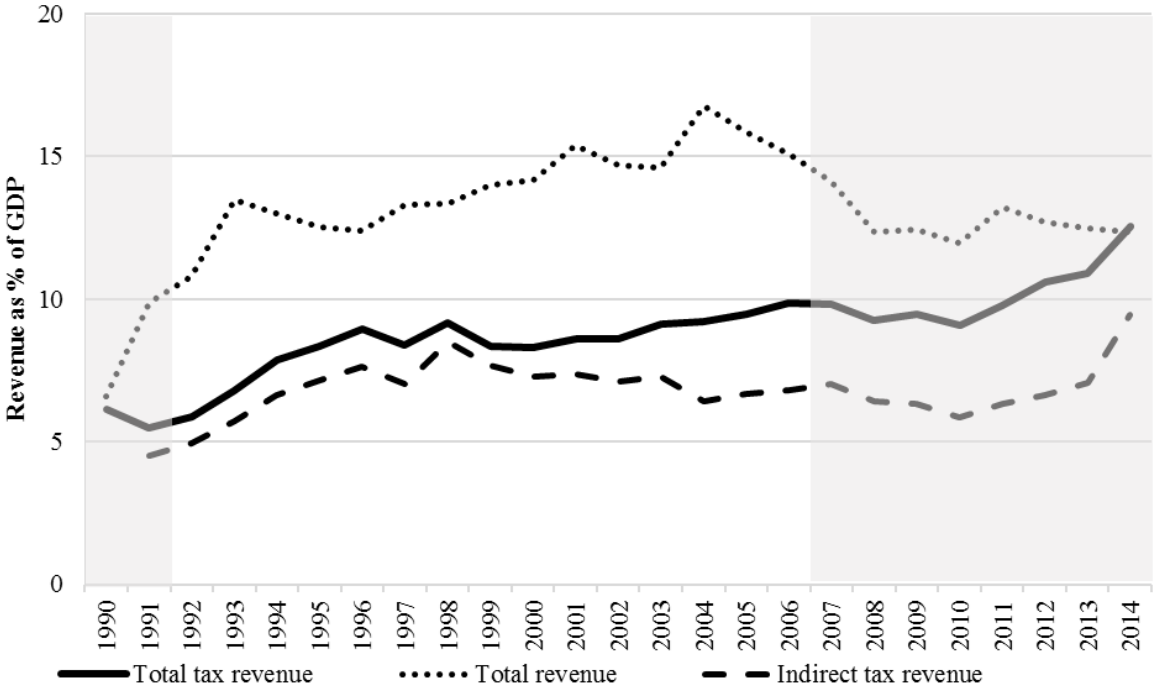
[12] One notable exception is the drastic reduction of the Graduated Personal Tax just before the 2001 presidential election, and its complete abolishment on 1 July 2005. The latter was surprisingly announced by the Minister of Finance just three weeks earlier, despite strong opposition from the political establishment. These were indeed major reforms since they comprised the largest revenue source for local governments (Fjeldstad & Therkildsen 2008 p.123; 131). The drastic way in which they were implemented aligns with the general picture of fiscal reform in Uganda, but is kept out of the analysis since the revenues are not directed to the central government.

Figure 5. Uganda's tax structure



Note: the recovery period is represented by the white area of the graph. Source: ICTD Government revenue dataset (Prichard et al. *2014).*

The stagnation of overall tax revenues after 1997 clearly reflects the trajectory of tax policy reform described above. After the first five years of recovery, central tax revenue continues to rise but only very modestly, reaching just below 10% in 2006.

This development of the fiscal structure gives credence to the assumption that tax policy reform is essential for the mobilization of domestic revenue in post-conflict states. Naturally, however, this is not the only – or even the most important – factor behind revenue mobilization. One can still note that Uganda, despite an initially strong fiscal performance, collected low amounts of taxes – even compared to other poor African states. There are several reasons for this: the structure of the economy, the continuation of conflicts, corruption, and finally an international community promoting neo-liberal policies.

First, and as described above, not only did the Ugandan economy contract during the civil war, but its composition changed remarkably. While the phenomena of informal or shadow-economies can be said to be a general feature of wars (see section 2.2, above), the breakdown of the commercial economy in Uganda was extraordinarily severe, with large parts of the population reverting to subsistence farming (Collier & Reinikka 2001 p.19f.). Ten years into the recovery period the agricultural sector accounted for 40% of value-added in Uganda, compared to an average of 16% for sub-Saharan Africa. This furthermore resulted in a low degree of monetization of the economy (Ayoki *et al.* 2005 p.8). Even if it was monetized and commercially directed, the low turnover in practice exempted this sector from VAT and income tax. Due to massive capital flight during the civil war (Collier & Reinikka 2001 p.29f.) there was precious little wealth to tax

either. In short, due to the effects of civil war on the structure of the economy Uganda had a very narrow tax base to mobilize revenue from.

Second, while 1992 marked a decisive turn towards recovery – in terms of conflict intensity, political priorities and macro-economic indicators – armed conflict soon returned to Uganda. During the latter half of the 1990's the conflict between the government and various rebel groups, among them the infamous Lord's Resistance Army, steadily intensified, reaching more than 1000 annual BDR. The armed conflicts continued to plague the country well into the next decade (UCDP 2016). Obviously, being unable to exert control over large parts of the country severely restricts the ability to collect taxes.

Third, corruption and inefficiencies in tax administration resulted in widespread non-compliance and week enforcement (Therkildsen 2004; Cawley & Zake 2009 p.120f.). This was identified as a large impediment to tax mobilization by the IMF, which subsequently recommended several reform measures (IMF Country Report 2005 p.14). Though the reforms of the Ugandan Revenue Authority was later deemed successful (IMF Country Report 2007 p.9; IMF Country Report 2009 p.36), these came too late result in any large improvements during the 15-year period under study.

Fourth, a neo-liberal policy of capital and trade liberalization, low inflation and exchange rate stability has consistently taken priority over tax mobilization. As noted above, not even the major tax policy reforms that were undertaken were primarily directed at raising additional revenue. Whether or not this represents a genuine ideological conversion of Museveni – previously a proponent of dirigiste economic policy (Tumusiime-Mutebile 2009 p.39) – is an open question. What is apparent is the practical rationality of such policies given the incentives created by international donors and IFIs.

While the conditionality of IMF is often blamed for coercing poor states to pursue policies in line with the teaching of neoclassical orthodoxy, in the case of Uganda, such an explanation is too simplistic. Rather than having to twist the governments arm, the Ugandan government has often surprised IFIs by implementing liberalizations or deregularizations by their own accord (Holmgren *et al.* 1999 p.36; see also e.g Byaruhanga *et al.* 2009 p.56). Indeed, as described above, the IMF has continually recommended a more balanced approach, including not only fiscal and monetary discipline, but increased efforts at domestic revenue mobilization.

Nonetheless, the macro-economic policies of the government have led to Uganda being a favorite country for international donors. While fluctuating from year to year, aid inflows have amounted to between a third and half of total annual revenue during the recovery period (Kuteesa *et al.* 2006 p.5). Obviously, this has contributed a great deal to development and poverty reduction in Uganda, but as Hisali & Ddumba-Ssentamu (2012) show using econometric analysis, it also seems to have decreased the domestic revenue mobilization efforts. Notably, in 1997 Uganda also became the first country even to get a significant portion of its foreign debt cancelled under the Heavily Indebted Poor Countries initiative (Ndikumana & Nannyonjo 2007 p.34; IMF 1997). As shown above, this year also marked the end of major tax reforms. Figure 5 provides a crude but telling

illustration of the logic behind this: despite stagnating tax revenues in the late 1990's and onward, total revenues continue to rise steadily from about 12.5% in 1996 to a peak of 17% in 2005. Hence without having to face public opposition to increased taxes – or adverse macro-economic indicators potentially dissatisfying donors – the government succeeded to continuously increase the revenue ratio by attracting foreign aid.

6.3 Lebanon 1990-2004

6.3.1 Background

The civil war in Lebanon raged from 1975 to 1990 causing close to 150,000 deaths and massive destruction (Ghosn & Khoury 2011 p.382).[13] The disruption of the conflict is perhaps best illustrated by the enormous – albeit fluctuating – drop in real per capita GDP, amounting to 67% from 1974 to 1990 (see Eken *et al.* 1995 Table 2). Importantly, however, while the formal economy was depressed on the whole, it did not experience a dramatic reversal into subsistence agriculture but largely maintained its modern structure dominated by trade and service industry (Gaspard 2004 p.189; Makdisi 2004 p.97).

A similar pattern can be discerned in the area of public finances. As the government's effective control of its territory weakened, the militias took over the role as tax enforcers, in the end controlling around a third of the economy (Kurtulus 2012 p.1297; see also Picard 2000). Consequently, the state lost most of its capacity to collect revenue; at the end of the war, government revenue amounted to only around 1% of an already extremely depressed GDP (Eken *et al.* 1995 p.12f.). In spite of this, there was never any real collapse of the state during the war. While public services could only be provided in a piecemeal fashion, the state continued to pay salaries to civil servants throughout the conflict (Najem 2000 p.92), thereby preserving a functioning (albeit inefficient) public administration.

In 1989, parliamentarians representing most of the major factions of the conflict put a symbolic end to the war with the signing of the Ta'if Agreement, coming into effect a year later.

[13] For a summary see UCDP (2016); for a detailed journalistic account see Fisk (1992).

6.3.2 Political structure

The Ta'if Agreement (1989) mostly concerned reforms to the political system which were to be implemented by amending the previous constitution. The only obvious power-sharing provision was the (temporary) article (II.A(5)) stipulating *equal* representation between Christians and Muslims as well as *proportional* representation of their respective sub-denominations in the Chamber of Deputies.

While not explicitly stated, the most important power-sharing features of the agreement rather concerned the decreased power of the President and concomitant increase in power of the Prime Minister and the Speaker of parliament. Specifically, while the President retained the prerogative of appointing the Prime Minister, he now had to do this "in consultation" with the Speaker. The Prime Minister, while responsible for chairing ordinary Cabinet meetings, in turn had to get the approval of the President to form it (see art. II.B and II.C). While there is no mention in the Ta'if Agreement nor in the amended constitution (see Lebanese Constitution 1995) of sectarian appointment of the mentioned posts, there is a long-established consensus about reserving the Presidential post to a Christian, the Prime Minister post to a Sunni Muslim and the Speaker post to a Shi'a Muslim (Haddad 2009 p.403). Hence, each of the three large denominations had (and still has) an effective veto power when it comes to government formation. In practice, therefore – and in accordance with its coding in the Large-N analysis – Lebanon had a very strong power-sharing system that effectively guaranteed executive representation of the major sects during its recovery phase.[14]

This congruence is not replicated with regard to the Veto Player variable. While for the original variable (Checks), Lebanon is assigned the value of 1 for the whole 15-year period, the re-coded Veto Player variable (disregarding political competition) is missing for the first 7 years, followed by a value of 3 between 1997 and 2000, and 2 thereafter.

This data is obviously not valid. Merely given the power-sharing configurations described above, the Lebanese political system should have *at least* 3 veto players throughout the recovery period. Indeed it is recognized that not only the process of government formation, but much of the continuous governance during the first decade and a half of peace was executed through consensual agreement within the power-sharing "troika" (Makdisi 2007 p.27).

Since the Council of Ministers is supposed to take decisions by consensus or in lieu of this is required to have a legal quorum of two-thirds of its members (Lebanese Constitution 1995 art.65), there is also considerable room for vetoing decisions within the cabinet. The Ta'if Agreement also abolished the power of the President to bypass the cabinet by issuing "urgent legislation" (Hudson 1997 p.113). Though the cabinet in practice only became an arena of serious contestation after the 2005 Syrian withdrawal, it did exercise its veto on a proposed tax reform at least once during the recovery period (see p.42).

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[14] For a more thorough discussion of the power-sharing features of Ta'if, see e.g. Ghosn & Khoury (2011) or Hudson (1997).

While most of the political contestation during the period of interest was played out within the "troika", and to a lesser extent the cabinet, the parliament also had formal and significant *de facto* powers to intervene on budget issues since each article in the budget must be approved separately by majority vote (Lebanese Constitution 1995 art.83). As explained bellow, this did in fact occur on several crucial occasions, especially from the late 1990's and onwards.

As noted in the theory section, veto players are not necessarily borne out of the domestic political system. Indeed the single most powerful political actor in Lebanon up until 2005 was without doubt the Syrian regime, as represented by their military presence.

Syria intervened in basically all political affairs during the period (Haddad 2009 p.405; Nizameddine 2006 p.106). Najem (1998 p.24ff.), however, points out that Prime Minister Hariri was given *carte blanche* from Syria in all matters of *economic reform*, so long as it retained its say in other political and especially military issues. While this situation changed dramatically in 1998, Syria seemingly exercised its veto powers through its allies *within* the *troika* or the parliament (Leenders 2012 p.209ff.). Consequently, regarding tax policy, it should not be regarded as a veto player in its own right.

Without going into more detail of the turbulent political structure in post-conflict Lebanon[15], it is clear that while it is undoubtedly correctly coded as a power-sharing political system, the assignment of either one, or two to three veto players for the whole period is incorrect. Rather, Lebanon should be assigned a minimum of three veto players throughout the recovery period, with the addition of up to two veto players during specific periods.

6.3.3 Fiscal reform

The first couple of years after the conflict ended were both economically and politically tumultuous. The overall focus of the government was however clear: in a consultation with the IMF, the government emphasized that together with infrastructure reconstruction, financial stability through the *mobilization of domestic revenues* would be the primary objective of the government. Monetary stability, it was assumed, would follow more or less automatically (IMF Consultation 1991 p.31f.).

Important as monetary policy was, it was hardly an issue of contestation; indeed the government continued to emphasize that "fiscal correction holds the key to financial stability" (IMF Consultation 1993 p.3). Hence, the fundamental question for a successful recovery would be how to raise sufficient domestic revenue. To this end, the second-in-command of the central bank at the time asserted that it would require a "comprehensive overhaul and reform of the tax and budget systems" (Saidi 1994 p.205).

[15] Including, e.g. nine different governments in the 15-year period.

An early study published by the IMF identified several weaknesses in Lebanon's tax structure. First, it had a very low level of direct taxes, mainly constituted by an outdated income tax. Consequently it was heavily reliant on indirect taxes – mostly levied on imports – which however had very low effective rates. It further lacked a general sales-tax (such as VAT), instead relying on excise taxes with narrow scope (i.e., taxing specific products). Finally, there were severe inefficiencies in the tax administration (Eken *et al.* 1995 p.16f.). Together with a lack of effective control, all of this contributed to a distortionary and unsustainable tax structure, yielding very low revenue.

A council responsible for economic planning and coordination was established in 1991, which included all top figures of the government and the central bank. With the fiscal situation being a top priority, the council discussed plans for introducing new taxes such as a sales-tax, capital income taxes and taxes on specific professions. During this time a non-political "committee of experts" was also appointed and tasked with drafting a plan for economic recovery. The resulting plan also laid particular emphasis on reforming the tax system – especially the income tax – as well as proposing a complete remake of the tax administration (Makdisi 2004 p.121f.).

The political response was quick but less than radical: in July 1992 measures were implemented to enhance tax collection and decisions were made to raise the gasoline tax[16] and adjust the dollar rate for customs (Makdisi 2004 p.124). While the latter may seem like a technicality, given the previously high dependence on import taxes and the massive depreciation of the Lebanese Pound, the fixed rate of 6 LP to the dollar (IMF Background Paper 1991 p.16) meant that the government received next to nothing in real value for every dollar worth of goods imported. Already in late 1990 the IMF urged the government to instead use market rates. The government indicated its intention to raise the customs dollar rate within six months, but considered it necessary to postpone the imposition of a full market rate (IMF Staff Report 1991 p.15). Apparently, however, instead of six months it took about eighteen for the first adjustment to be implemented. With the new rate set at 800 LP to the dollar, it represented only about half the market exchange rate (Eken *et al.* 1995 p.15). In the following years, the IMF continued to urge the government to implement market rates – which could close to double import tax revenue – but to no avail (IMF Consultation 1993 p.21; IMF Staff Report 1994 p.11). While a law to that effect seems to have been drafted in 1993 (Eken *et al.* 1995 p.15) the market exchange rate for customs was only implemented in 1995 – five years after it was first discussed – together with a minor tariff reform (IMF Consultation 1996 p.15; Helbling 1999 p.16).

The proposed adjustment of income taxes was also delayed because of political resistance, despite previous the endorsements by both the political elite and the IMF. But in mid-1993 the government finally laid out a proposal for a simplified income tax in line with IMF recommendations (IMF Staff Report

[16] Which was still, however, comparatively low, as noted by the IMF (IMF Consultation 1993 p.22)

1993b p.8). Prime Minister Hariri eventually managed to get the modified income tax law through parliament on 30 December 1993 (Makdisi 2004 p.125), i.e., the very last day of the parliamentary budget session. Principally it meant a reduction of the number of rates, as well as a *decrease* in the effective tax levels of both personal and corporate income tax (Eken *et al.* 1995 p.14f.). A flat 5% tax on capital income was also introduced, but notably, interest on savings and government bonds remained exempt; it would take almost a decade until this exemption was finally revoked, in January 2003[17] (Makdisi 2004 p.125). Given the significant banking sector and the banks' massive – and arguably inflated – income from government treasury bills at the time (Gaspard 2004 p.217-220) this delay represented an enormous loss in potential revenues.

The following years were characterized by a virtual standstill regarding tax reform. The IMF continued to press the government on revenue increasing reforms; while acknowledging the stiff parliamentary opposition to tax increases, the IMF urged the government to swiftly adopt revenue enhancing reforms and especially to speed-up the implementation of a general sales-tax (such as VAT, already discussed in 1991) (IMF Staff Report 1994 p.9-11; IMF Consultation 1994 p.25-37).

However, in the domestic political arena, the conflict over taxes and other budgetary policies only intensified. The government faced considerable difficulties with getting parliamentary approval of the 1997 budget, which in the end included no new revenue increasing measures (IMF Staff Report 1997 p.11). Furthermore, when PM Hariri then presented plans for raising gasoline taxes it was vetoed in the cabinet, leading to a government crisis (Dibeh 2005 p.16; Nizameddin 2006 p.108).

The 1998 budget faced equal difficulties, being delayed because of "intense discussions" within the *troika*, the cabinet and the financial committee of the parliament (IMF Consultation 1997 p.22) but was finally approved, including some minor tax adjustments (Lebanese MoF 1998 p.28f.). The real test of the political system came with the 1999 budget. With a deteriorating economic situation the new government under PM Salim Hoss was under intense pressure from the public, the IMF, local academics and indeed the business community (!) to initiate a comprehensive tax reform in order to raise revenues (Bank Audi 1998 p.5; Bank Audi 1999 p.7; Daily Star 1998; Daily Star 1999b). But yet again, serious disagreements within the *troika* stalled the budget process (Daily Star 1999c). After having reached a compromise in June 1999 (i.e, six months after its intended implementation) the budget was finally presented to parliament, where it was approved in spite of stormy debates (Daily Star 1999d).

While hardly a comprehensive revision of the tax system, it included moderate increases of the previously extremely low effective income taxes as well as

[17] This was a particularly sensitive issue within the political establishment (see Daily Star 1999a). Its adoption in 2003 came after intense disagreements in the parliament (IMF Supplement 2003 p.4).

changes in inheritance and property taxes.[18] However, the delay meant that the reform could not come into effect until January 2000 (Lebanese MoF 2000 p.13), i.e., a full year after its intended implementation. Furthermore, the basic "schedular" structure of the income tax system – as established in 1959 (Azzi 1998 p.121) and deemed outdated by the IMF already in the early 1990's – remained unchanged. The authorities then stated their clear intention to implement a completely new "global" income tax as a part of the new five-year "fiscal adjustment plan" (Lebanese MoF 2000 p.3). Progress stalled however, and in 2002 the Finance Minister announced that the new "general income tax" would have to wait until 2004 (Daily Star 2002). Despite having received technical assistance and developed a comprehensive plan for the new income tax law, political divisions resulted in yet another postponement. The IMF and the Lebanese authorities thus agreed that the new Global Income Tax would be fully implemented by 2007 (IMF Staff Report 2004 p.17).[19]

The most important aspect of the "five-year adjustment plan" was, however, the decision to fully implement VAT by the start of 2001. As noted above, the issue of a general sales-tax was already up for discussion at the highest political level in 1991. A few years later, it apparently got renewed attention, and in 1994 the IMF urged the government to speed-up the process of adopting such a tax, which it projected could be implemented in 1996 (IMF Consultation 1994 p.37). From 1994 and onwards it became the single most salient revenue issue in the IMF consultations, with both staff and directors repeatedly compelling the government to introduce it without delay. Despite government statements about postponing the implementation due to the difficult political environment, the IMF insisted that it should be adopted at the latest in early 1997 (IMF Staff Report 1996 p.13f.).

When a precise date for the implementation of the VAT was finally decided (1 January 2001), the IMF was satisfied but emphasized the importance of keeping the time-table (IMF Consultation 1999 p.78; 85). At this time, the necessity of reform became tangible: the introduction of VAT was a condition set by the EU for the signing of an Association Agreement with Lebanon (Daily Star 2001). It also became a practical necessity since the terms of the agreement would drastically reduce the hitherto essential revenues from import taxes (Fedelino 1999 p.71).

Despite the firm commitment of the government, the adoption of the 2001 budget was delayed for six months until June 2001 (IMF Background Paper 2001 p.19), and did not contain provisions for the VAT reform. Instead it was planned to be implemented as of January 1 2002 (IMF Consultation 2001 p.4). In the end, while the VAT-law was passed in December 2001 it could not be implemented until February 2002 (Lebanese MoF 2002 p.15), i.e. after a 13 months delay. At

[18] Other proposed reforms, such as a new "business tax" were dropped (IMF Background Paper 2001 p.17), only to be adopted two years later (see IMF Staff Report 2001 p.6).
[19] The plan could not be implemented and as of May 2016 the old schedular income tax from 1959 is still in place.

implementation it consisted of a single 10% rate with a turnover-threshold of 500 million LP (*ibid.*) (approximately 330,000 USD).

In the Budget law of 2003 – approved in April that year – the threshold was lowered to 300 million LP (Lebanese MoF 2003a p.26), and it was further planned to decrease it to 150 million LP at the start of 2004 (Lebanese MoF 2003b p.4). Though the threshold was indeed reduced in 2004, it was set to 250 million LP, and was only lowered to the envisioned 150 million LP a year later (Lebanese MoF 2005 p.38).

Notwithstanding the very slow implementation, compared to other countries at the time, the new Lebanese VAT had a strikingly narrow scope. Out of more than 120 countries that had VAT in 2001, only seven had higher thresholds than Lebanon had in 2004[20] (i.e. approx. 166,000 USD). In addition, with a VAT rate of only 10% it placed itself among the bottom 25 countries (see Ebrill *et al.* 2001 Table 1.3).

The IMF experts considered this rate to be exceedingly low, and suggested an increase to 15-20% as soon as possible. The government was unwilling to concede to this and instead stated its intention to raise it to a moderate rate of 12% in 2004 (IMF Staff Report 2002 p.16). Once again, due to severe political disputes – seemingly within the *troika* itself (IMF Consultation 2004 p.32; 38) – even this ambition failed to be realized, and the plan for a VAT-rate hike was postponed to 2005 or 2006 (IMF Staff Report 2004 p.17).[21]

It is finally worth noting that despite experiencing severe inefficiencies in tax administration, reforming the tax agency was never a priority of the domestic political establishment, and accordingly no major administrative reforms were implemented during the recovery period (Makdisi 2004 p.127).

6.3.4 Tax structure

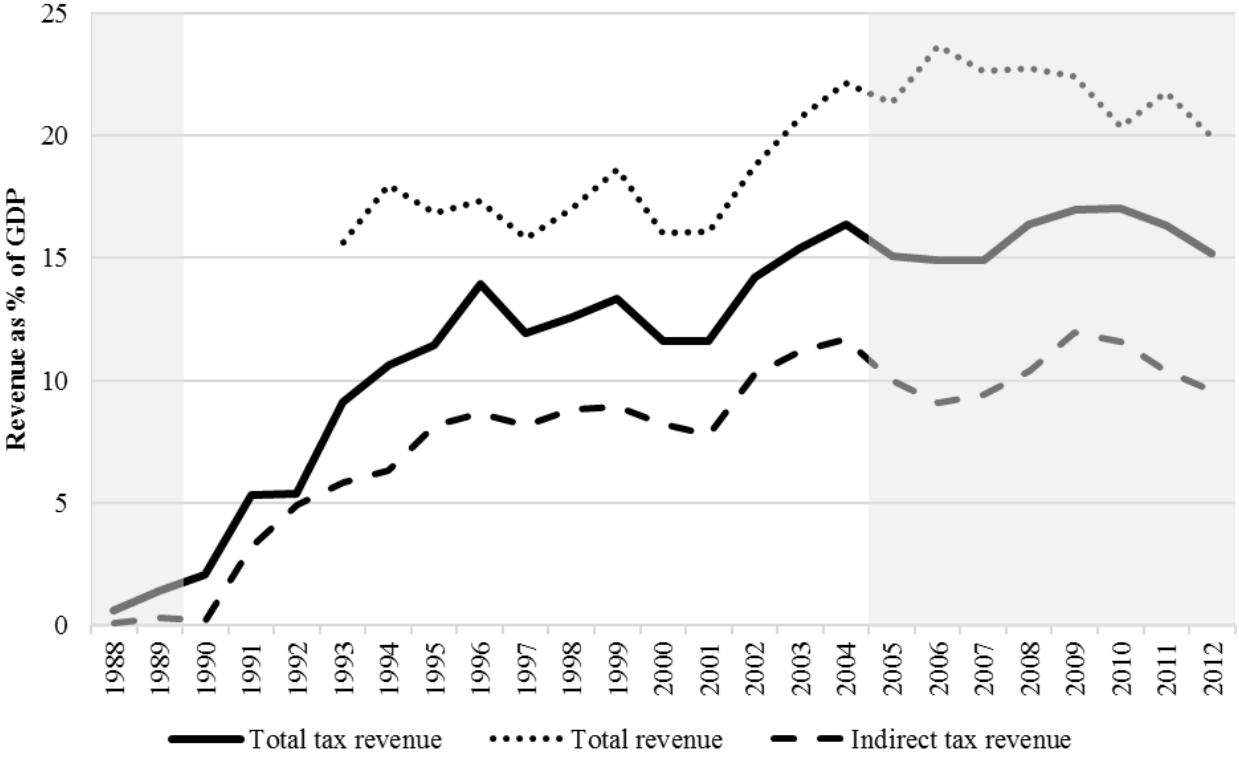
Figure 6 shows the development of total tax revenue, the share of indirect taxes as well as total revenue in Lebanon during the period investigated above. Strikingly, central government tax revenues increased from just a few percentage points of GDP in 1990 to around 14% in 1996. Thereafter, a slight decline can be observed, until 2001 when it yet again started to rise rapidly to peak around 16% in 2004. Notable is also the continuously high share of indirect taxes.

The increase in tax revenue for the first years between 1990 and 1992 was almost exclusively due to the reestablishment of government control over the

[20] If we instead compare with the final level of approximately 100,000 USD, Lebanon is still only surpassed by twelve countries.

[21] While continuously being at the top of the fiscal policy agenda (see e.g, IMF Country Report 2014), as of May 2016 no VAT-rate increase has been implemented.

Figure 6. Lebanon's Tax Structure



Note: the recovery period is represented by the white area in the graph. Source: ICTD Government Revenue Dataset (Prichard et al. *2014).*

ports and the simultaneous recovery and formalization of the previously collapsed economy. The continued increase in the subsequent years, can primarily be attributed to an increased efficiency in tax administration and the reforms of the tariff rates and customs dollar rate in 1995 (Helbling 1999 p.15f.). The stagnation of tax revenues in the years thereafter is a reflection of the political dead-lock at the time, with new tax reforms vetoed and severely depleted and delayed budget laws. While there was an upwards adjustment of income tax rates in 1999 (implemented in 2000), the modest increases had only a very limited positive effect on overall tax revenue due to the small contribution from direct taxes.

The introduction of the VAT in February 2002 is clearly visible in Figure 6, resulting in a tax revenue increase of more than 2 percentage points compared to the year before.

Clearly, the tariff reforms of the mid-1990's and the much-delayed implementation of VAT were both essential for the developments in tax structure during the period under study. As has been clearly shown, these – and especially the latter – were remarkable exceptions in a recovery period otherwise characterized by a complete lack of decisive tax reforms due to disagreement within the *troika* and the cabinet or fierce opposition in parliament.

While increase in tax ratio from a few percentage points to around 16% may at first glance seem impressive, this can largely be attributed to the post-conflict dynamics of the Lebanese economy itself. As noted, while extremely depressed at the end of the civil war, the economy maintained a strikingly modern structure,

dominated by trade and services. Hence, as soon as the security situation improved – which it did quickly without serious relapses – the pre-war tax base, consisting largely of easily taxed international trade, swiftly reemerged. Furthermore, while the Lebanese tax administration has received criticism for inefficiency and corruption, importantly, it was preserved for the duration of the war and could consequently reassert its authority immediately after the cessation of the conflict.

Lastly, as a middle-income country, Lebanon could never count on large amounts of foreign aid to cover its current expenditures. Hence, there was seemingly always a resolve from the political elite to mobilize the needed revenues domestically. This translated into a multitude of fiscal plans, a host of draft laws, and in the end an irregular stream of minor tax revisions.

Hence, despite a relatively favorable economic structure (compared to other post-conflict countries) and a resolute political will, the tax ratio only reached a very low level of 16% at the end of the recovery period.[22]

6.4 Analysis of case study results

Both case studies clearly show the problem of quantitatively measuring veto players in the population under study. Regarding the original Checks-variable, taken directly from the World Bank's DPI (Beck *et al.* 2001), a close scrutiny of Uganda's political system during recovery showed that it was indeed correctly assigned as *one* veto player. However, given the ban of political parties, the coding of the variable (focusing on parties) means that it would not have registered if for example the parliament acted as a veto players. In the case of Lebanon – in reality having between *three* and *five* veto players – the assignment of *one* throughout the recovery period is obviously incorrect.

While the re-coded Veto Player variable was less far off (scoring between *two* and *three*), the missing observations for the first seven years is troublesome. For Uganda, all observations on Veto Players except for two years are missing. In sum, both case studies show that the conventional operationalization of veto players (Checks) has serious validity problems. This is only somewhat mitigated with the recoded variable (Veto Players); the quality of the underlying data furthermore results in so many missing observations that it could undermine its reliability.

In contrast, the binary coding of Power-Sharing was correct in both cases. The lack of any power-sharing agreement in Uganda meant that Museveni could adjust

[22] A further illustration of the insufficient level of tax revenues is the enormous public debt that had accumulated during the period: from a level of 50% of GDP in 1993, it reached 185% in 2003 (IMF Background Paper 2004 p.23), possibly the highest in the world at the time.

the political institutions as he saw fit. Twice, the government of Uganda steered clear of including such provisions in peace agreements. As was evident regarding both the temporary re-imposition of the coffee export tax and the implementation of the VAT, there were indeed powerful societal groups at the time which could put up serious resistance to the government. However, without any distinct oppositional groups in the executive (or the parliament) who could pick up and utilize the public discontent, the popular obstructions were unable to get a political foothold. Consequently, Museveni could win the struggles by offering some largely symbolic concessions. While the pace of reform grinded to a halt in the latter half of the period under study, there is nothing that indicates that this was due to political obstructions. Instead, large flows of foreign aid – from donors seemingly more concerned with price stability than fiscal sustainability – reduced the *need*, and by implication, the *political will* for fiscal reform. Hence, the case of Uganda rather illustrates that the absence of executive power-sharing is a *facilitating*, but not *sufficient* condition for tax reforms.

Though lacking explicit provisions of executive power-sharing, the Ta'if Agreement resulted in a political system in which the three major sects had effective veto powers, as institutionalized in the *troika*. Reoccurring conflicts within the *troika* regularly led to delayed draft budget laws, which once in parliament were then often stripped of any provisions for major tax adjustment. In spite of early propositions from the highest political levels regarding major tax reform, only the VAT was eventually implemented. The much needed – and in principle sought after – comprehensive income tax reform could never be agreed upon within the *troika.*

These political conditions were furthermore closely related to the post-conflict settlements. In other words, the veto powers (or lack thereof) were largely derived from the existence of agreements of power-sharing, rather than merely resulting from the formal political system or party competition.

Both cases shows ample empirical support for the first step in the causal model: i.e., in a political structure with very few veto powers (Uganda) tax reforms can be quickly passed and implemented; where a power-sharing agreement give rise to considerable veto powers (Lebanon), however, tax reforms tend to be stalled, depleted or dropped all together because of political obstructions.

While both countries evidently had both a pressing *need* and *political will* for reform during post-conflict recovery, a between-case comparison shows a striking difference in terms of the number and speed of tax reform implementation. The Ugandan government managed to fully implement one *major adjustment* (substituting import for export taxes) and three *major reforms* (establishing the URA in 1992, introducing VAT in 1996, and implementing the new Income Tax Act in 1997) in the first six years of recovery. For Lebanon, the customs revision completed in 1995 represents a *major adjustment* but came about only after five years of discussion. The one *major* reform which took place during the recovery period was the introduction of VAT in 2002, which although deemed successful was moderate in scope and notably took over a decade to finally implement.

The economies of Uganda and Lebanon are too different to allow for a controlled comparison of tax outcomes between them both. Indeed, Uganda had a lower average tax ratio than Lebanon – mostly attributed to a significantly less developed economy. What could be shown, however, was that the tax reforms were closely linked to changes in tax structure and especially a rising tax ratio *within* each country. Hence, while there are many contributing factors affecting the tax ratio, in the longer term we can conclude that tax reforms are essential in order to raise tax revenues in post-conflict countries.

7 Concluding discussion

A century ago, Keynes warned about the dangers of a politically motivated and vengeful redistribution of economic resources between the states of Europe in the aftermath of the First World War. The results of this thesis indicate that the predicament of modern post-conflict countries can be properly conceived of as a mirror image of 1919. Due to *inconsideration* rather than vengeance, contemporary post-conflict political settlements threatens to *impede* necessary redistribution, thus potentially cementing the unjust and potentially crippling structures of the war-time economy.

The above study has had the ambition to investigate how the political structure in post conflict countries affects the state's ability to mobilize domestic revenue. Regarding the effects of veto players as conceptualized by Tsebelis (2002), the statistical results were weak and if anything indicated effects contrary to the main hypothesized causal model. If valid, these results would certainly be interesting. However, the in-depth qualitative analyses of the political systems in the two case studies revealed not only that the original operationalization (Checks) had severe validity problems, but that this was also true to some extent for the re-coded version (Veto Players). Arguably, therefore, the statistical result do neither confirm nor refute hypothesis 1; we simply cannot say whether or not veto players as defined here has an effect on the tax ratio. Still, the World Bank's Database of Political Institutions (Beck *et al.* 2001) is the only available data source with a comprehensive sample of non-OECD countries which includes data on veto players. This arguably reflects a more general problem for research on post-conflict countries. Thus, the qualitative analysis of veto players importantly points to a pressing need for data on political institutions in developing countries which is both *theoretically valid* and has a *comprehensive coverage*.

On the other hand, the statistical analysis showed strong evidence of an independent negative effect of power-sharing on tax revenue. The case studies in turn gave credence to the proposed causal mechanism. In Uganda, where the executive was not constrained by a power-sharing agreement, an initially reform-minded political elite could swiftly implement comprehensive tax reforms; in Lebanon by contrast, the mutual veto powers established by the Ta'if agreement caused constant delays and abandoned reform attempts. Hence, by both verifying the hypothesized negative *effect* and demonstrating the *causal mechanism*, the combined analyses provides strong enough proof to conclude that *by giving rise to policy inertia, power-sharing agreements do affect the mobilization of domestic revenue negatively.*

The results have several important implications. First, in line with much of the literature in comparative political economy reviewed in the theory section, it is reasonable that lower tax revenues due to policy inertia have wider fiscal

consequences in terms of debt and expenditure. On the other hand, post-conflict countries differ substantially from the typical industrialized country regarding e.g., overall-revenue structure and access to international capital markets. While this study had to be restricted to tax revenue due to mandated limitations in scope, relevant fiscal data is readily available (e.g., IMF World Outlook Database) and could form the basis of further research.

The other side of the equation is the distribution of costs due to taxation. Regardless of the *level* of taxes, all taxes will be borne unevenly by different groups – indeed constituting an axiomatic assumption in the above theoretical framework. First, this means that if intensely levied on certain sectors, tax systems can be inefficient or "distortionary", thus damaging the productivity of the economy. Second, depending on which economic activity it targets, and especially how income is taxed, different classes will bear the costs, thus always making it an issue of fairness and equity. When the economic structure has been turned on its head during a war, enriching a few and impoverishing the multitude, reforming the tax system is therefore a prerequisite for both efficiency and economic justice.

By opening up the "black box" of domestic political institutions and their impact on economic outcomes this study has contributed to the scientific knowledge about the political economy of post-conflict countries. The theoretical conclusions are clear: rather than constituting blank slates upon which IFI's can implement their policies with discretion, the economic policies and outcomes of post-conflict countries are to a significant extent the result of the domestic political structure – in turn, most often a reflection of the conflict-settlement. Indeed, this study has found no indication of a direct negative effect of IMF involvement on tax policy or revenues. In fact, in the approximately 60 internal IMF documents reviewed in this study, recommendations for increased and reformed taxes were one of the most salient issues. This does not mean that the *incentive structure* created by a fragmented but powerful community of international actors – conditioned by a neo-liberal paradigm of price-stability and free trade – is insignificant. It does, however, caution against habitually pointing to IFI's as the sole culprit behind failed or uneven economic development in post-conflict countries.

Taxes represent a large and generally stable source of revenue for the state, which for most countries constitute a *sine qua non* for the delivery of equitable public services and development promoting investments. Seen in this perspective, the often overlooked and ostensibly technical issue of tax reforms is a small but essential condition for the attainment of a just and sustainable peace. The results of this thesis should therefore encourage researchers and policy-makers concerned with peacebuilding to consider the often overlooked connections between domestic political institutions and fiscal policy. While representation is a fundamental democratic ideal, guaranteed veto rights are not. Hence, post-conflict political settlements must not only be geared towards the short-term achievement of peace through power-sharing agreements, but also make sure that the resulting veto powers do not suppress much needed economic reforms. In short, the prospects of economic justice should not be sacrificed on the altar of political stability.

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9 Appendix I. Sample delineation

Defining "conflict" in a meaningful way is a difficult task. At the very outset, it can be differentiated from both peaceful contestations and unorganized violence; it rather denotes a form of politically motivated organized violence commonly described as war. It also excludes instances of one-sided violence. So far, the definition merely follows basic terminological conventions.

But armed conflicts are furthermore commonly grouped into sub-classes according to the relationship between the parties or where in the political system they take place. Uppsala Conflict Data Program for example, categorizes conflicts into extrasystemic, interstate, internal or internationalized internal (UCDP/PRIO 2015 p.9). Remember, however, that besides the normative imperative of achieving development in post-conflict countries, there are two main factors that motivate this study's focus on fiscal capacity in these states. First, because of war-time destruction they tend to have exceptional developmental needs; and second, the political systems that are supposed to enable this development are typically fragile and/or contested. The political level of the conflict determines neither of these factors by definition. All conflicts (as defined here) cause disruption on *some territory.* Likewise, the political character of the contestation does not neatly translate to a certain political predicament in the post-conflict phase. Concretely, internal conflict may end with secessions, producing cohesive post-conflict entities (e.g. Eritrea) while interstate conflict may end with incorporation/unification of previously separated entities (e.g. Yemen).[23] The key then, is not the international/internal character of the conflict but *on which territories it has taken place*.

Since we are only interested in the cases were the conflict actually causes significant disruption (and hence can be subject to *recovery*), there has to be a lower bound for the intensity of the conflict. Usually measured as going beyond a certain threshold of yearly battle-related deaths (BRD), this is perhaps the most problematic aspect of how to define armed conflicts (see Cramer 2006 p.59ff. for a discussion). Most problematic for the present purposes – concerned with the conflict's impact on the *state level* – is the convention of measuring the *absolute number of deaths*, thus disregarding the varying impact this will have on countries of different sizes. Sambanis (2004 p.882) accordingly advocates the introduction of a per capita threshold instead. However, since it is problematic to implement such a measurement on already existing databases of conflicts (*ibid.*), it is

[23] Note also the often used examples of post-WWII European states like France and Italy, who in spite of returning to a pre-war political entity, where dragged down by fierce internal political conflicts.

regrettably not viable as a general selection rule for this study.[24] Instead relying on established scholarly conventions – while recognizing its arbitrary nature – this study will implement the UCDP classification of "minor armed conflict" as a minimum criterion. Accordingly, a conflict is here required to have had more than 25 BRD per year (UCDP/PRIO 2015 p.8).

We face many of the same problems when trying to establish when a war ends, i.e., defining the "post-". Indeed, as many scholars have pointed out, for many purposes it is more accurate to speak of a "continuum of violence" rather than distinct episodes of conflict (e.g. Cohn 2013 p. 21; Cramer 2006 p.84f.). For the purpose of internal coherence, however, a sufficient condition for the beginning of a post-conflict episode will be the last year in which the number of BRD is above 25. Furthermore recognizing that the central interest of this study is a *political process*, whose initiation is not strictly connected to the secession of violence, it is reasonable to include the signing of a peace agreement as a second sufficient condition.

These two sufficient conditions are in line with UNDP's (2008 p.5) minimalist definition of the start of a recovery-period (see also Sambanis 2004 p.830f. on the end of civil wars). However, the outer bound of such a recovery period is perhaps even more vague that the start of it. While many studies use some sort of economic indicator (e.g. the return to pre-war GDP) to determine the recovery-period for each country (see e.g. Flores & Nooruddin 2009), in this study there is a need for a more general definition.

According to the UNDP (2008 p.111) it typically takes 11-12 year of recovery to return to pre-war GDP levels. Kugler *et al*. (2013 p.4) in turn calculates that it takes 15-18 for a full productivity and wealth recovery. A 15-year period is therefore deemed fitting to encompass the crucial aspects of recovery in most post-conflict countries.

The selection of cases has been made on the basis of the following sources: UCDP Conflict Encyclopedia (2016) for battle-related deaths and general conflict data; the Peace Accords Matrix (2015) for supplementary data on peace-agreements; and, for a few cases, the World Bank (2016) for data on GDP per capita trends. Table A.I below presents the selected 34 recovery periods.

[24] It has however been used on a case-by-case basis: some very large countries with only minor or local conflicts, such as Indonesia (Aceh), Russia (Chechnya, Dagestan), India (various local conflicts), have been excluded from the sample.

Table A.I. Countries and recovery-periods under study

Country	Start of recovery	Last year of study
1. Angola	2002	2015
2. Azerbaijan	1994	2008
3. Bosnia & Herzegovina	1995	2009
4. Burundi	2008	2015
5. Cambodia	1998	2012
6. Chad	2010	2015
7. Congo-Brazzaville	1999	2013
8. Croatia	1995	2009
9. Djibouti	2001	2015
10. El Salvador	1992	2006
11. Eritrea	2000	2014
12. Ethiopia	2000	2014
13. Georgia	1993	2007
14. Guatemala	1996	2010
15. Guinea-Bissau	1998	2012
16. Haiti	1991	2005
17. Ivory Coast	2004	2015
18. Lebanon	1990	2004
19. Liberia	2003	2015
20. Macedonia	2001	2015
21. Mali	1992	2006
22. Mozambique	1992	2006
23. Nepal	2006	2015
24. Nicaragua	1990	2004
25. Papua New Guinea	2001	2015
26. Philippines	1996	2010
27. Rwanda	2002	2015
28. Senegal	2005	2015
29. Sierra Leone	2000	2014
30. Sudan	2005	2015
31. Tajikistan	1998	2012
32. Timor-Leste	1999	2013
33. Uganda	1992	2006
34. Yemen	1994	2008

10 Appendix II. Data description

Table A.II. Variables and descriptive statistics

Variable	Description	Mean	Min	Max	Std. Dev.	N.
Tax Revenue	Central government tax revenues, % of GDP. Source: ICTD Government Revenue Dataset (Pritchard *et al.* 2014).	11.198	0.550	29.052	4.939	394
Checks	Measuring effective "checks and balances", set to 1 if political system is uncompetitive. Source: WB Database of Political Institutions (2012), Beck *et al.* (2001).	2.444	1	9	1.454	403
Veto Players	Measuring effective "checks and balances", without original competitiveness restriction. Source: WB Database of Political Institutions (2012), Beck *et al.* (2001).	2.846	1	9	1.350	338
Power-Sharing	Equals 1 if a power-sharing agreement has been signed. Source: Peace Accords Matrix (Joshi *et al*. 2015).	0.386	0	1	0.487	474
BRD Index	Cum. nr. of battle-related deaths in 10 years preceding conflict termination, by 1000 inhabitants. Based on data from World Development Indicators (2016) & PRIO Battle Deaths Dataset 3.0 (Lacina & Gleditsch 2004).	0.280	0.002	2.682	0.549	474
IMF Program	Equals 1 if an IMF-agreement is in effect. Based on data from Dreher *et al.* (2015).	0.310	0	1	0.463	474
Fractionalization	Mean of religious, ethnic and linguistic fractionalization, constructed as a Herfindahl Index. Based on Alesina *et al.* (2003).	0.511	0.005	0.829	0.199	474
GDP per capita	In constant 2005 USD, in metric of 1000 for easier interpretation. Source: World Development Indicators (2016).	1.356	0.135	11.516	1.848	440
Non-tax Revenue	Central government non-tax revenue, as % of GDP. Source: ICTD Government Revenue Dataset (Pritchard *et al.* 2014).	6.403	-3.174	71.678	10.685	374
Grants	Foreign aid received, as % of GDP. Source: ICTD Government Revenue Dataset (Pritchard *et al.* 2014).	2.899	0	24.721	3.805	402

Note: the summary statistics is based on the original time-series cross-section data, as used in model 4 and 5, presented in Table 1. Both panel and aggregated cross-section datasets are of course available upon request.